PATNA UNIVERSITY

Banaili Readership Lectures

1930-31

INDIAN BANKING

With Special Reference
to Bihar and Orissa

BY

Mr. J. A. HUBBACK, M.A. (Cantab.), I.C.S.,

President of the Provincial
Banking Inquiry Committee,
B. & O., 1930

Published by Patna University, Patna, 1931

FOREWORD

These lectures were delivered in Patna at the end of February and the beginning of March 1931, being those required of the Banaili Reader in Economics for that year. They are published under the direction of the Patna University. I have to thank Professor J. H. Clapham and Mr. E. L. Tanner for examining the typescript and giving me their very valuable comments.

J. A. HUBBACK.

July, 1931.

LECTURE I.

Introductory.

A Sketch of the All-India Position.

The title of the course of lectures which I have been asked to deliver to the Patna University is "Indian Banking with special reference to Bihar and Orissa." My claim to your audience is somewhat slender since I am not a banker and have little direct knowledge of economic problems outside this province. I am here before you because two things have happened. I was put forward by the Government of this province to preside over the provincial committee on banking, a committee which, like those appointed for the other provinces of British India, had the duty of presenting to the Central Committee a picture of local banking conditions. That picture is drawn in our Report and is the principal source of the information and ideas which I propose to put before you. The second thing that happened was that just when we had finished the discussion of our Report and I was inclined to murmur *opus feliciter consummatum est* (which is the Latin for " a good job done ") your ex-Vice-Chancellor, Sir Sultan Ahmad, instigated, I believe, by my friend Professor Batheja, invited me to deliver these lectures. I have several times regretted that I had not the strength of mind to decline a task, which my lack of leisure and knowledge has prevented me from performing to my satisfaction. But unfortunately I lack the supreme weakness of character that would enable

me cheerfully to shirk an arduous undertaking to which I have committed myself.

I read the other day a story of Thackeray. He was delivering his essays on "The Four Georges" as a series of lectures at a public hall in London. At the conclusion of them a friend greeted him with the words—

"Capital my dear Thack, but you ought to have had a piano."

I feel that those of you who do me the honour of listening to me for six evenings, may also feel that way.

To return to the subject of my lectures. Two questions leap to the eye or ear. What is banking and what is Bihar and Orissa. The second question is the easier. Bihar and Orissa is shorthand for an agglomeration of human beings, engaged in numerous, if not (*pace* the Census Superintendent) numberless occupations from which they derive their livelihood. The only physical links are continuity of location on the earth's surface, and liability to pains and penalties for disobeying the laws, which are in force in that location. The spiritual, or perhaps you may prefer to say the metaphysical links, are really the more important, a loyalty to the idea of promoting the prosperity of the province as a whole, and a desire to make Bihar and Orissa a worthy unit in the greater integral of India; the racial or religious connections, which spread from one district to another and bind up fractions of the population into communities, whose divergent interests have to be reconciled; the ties of home and family on which ultimately the larger loyalties have to be built up.

Interlacing with these are the economic connections which enable individuals and groups of individuals to earn their livelihood by satisfying the demands of others, whom they may never see. It is in promoting the healthy working of these last connections, in making them strong enough to take the strain of adverse circumstances and elastic enough to divert the direction of the economic thrust and pull without snapping them, that banking finds its function.

The next point is, what is banking? An examination of the questionnaire which formed the basis of our enquiry, as it did of the enquiries of the other Provincial Committees, shows that that is not an easy question to answer. It might even appear that the sphere of banking or at any rate of banking enquiries was so large as to defy definition. But banking may be strictly defined as including receipt and use of *deposited* money, as well as use, by way of loaning and discounting of *owned* capital. If the former function is essential to banking, then much of the credit system of Bihar and Orissa is carried on without banking agency. A real banker is a trader, who both sells and buys the right to receive money in the future. If he only sells that kind of right, he is *marketing* his produce, *i.e.*, his own savings, and not *trading*. Hence it follows that money-lending pure and simple, is not banking in the strict sense. At the same time, when examining the present position of banking proper, it is clearly necessary not only to see what part the banks are actually playing in their primary sphere of providing credit, but also what is the extent of that sphere, what

agencies also operate in it, and why banks are unable to occupy a larger extent therein than they actually do. Thus the enquiry in which our Committee played a part has rightly covered, from a particular point of view, very nearly the whole of the economic activities of India.

I feel I am subject to two disabilities in dealing with the subject of these lectures. In the first place the part allotted to our Committee was necessarily a restricted one. We were not required to examine from a banking point of view the major industries of India as they affect this province, *viz.*, coal, iron and steel, jute and cotton. Of these the first two are of vast importance to us in Bihar and Orissa. Nor were we called on to follow the products of our province that command an outside market beyond their arrival at the ports, and consequently the whole business of the Exchange Banks was outside our enquiry. To the Central Committee also has been reserved the task of examining the problem of a Reserve Bank in the light of the facts, which the Provincial Committees have been able to supply along with those which its own enquiries have elicited, and of exploring the very important field of banking education. My second disability arises from the fact that the Central Committee has not yet reported, while there is yet a third stage in the Banking Enquiry to be taken up, *viz.*, the consultation between that Committee and banking experts from other countries. It is impossible to render a survey of banking problems in Bihar and Orissa intelligible without some reference to conditions, which it was not the function of the Provincial Committee to investigate. It is also

impossible for me to deal even sketchily with the larger problems of Indian banking, without feeling that my presentation of them may be found not only imperfect but positively erroneous in the light of the comprehensive and authoritative survey of them, which we expect to have before us in the course of this year. The main portion of these lectures will thus be devoted to the banking problems of Bihar and Orissa. But before I enter the narrower sphere, I will venture to give a very inadequate sketch of the general Indian position.

Fully organized banks of a western type in India fall into four classes. In the first there is only one representative, the Imperial Bank, formed as you know in 1921 by the amalgamation of the three Presidency Banks and regulated by its own special Act. The oldest of the Presidency Banks, the Bank of Bengal, was founded in 1806. In the second class come the Exchange Banks which are 18 in number, their special feature being the location of their head offices elsewhere than in India. Eight are located in Great Britain, three in Japan, two in the United States, two in Holland, and one each in France, Portugal and the Colony of Hong Kong. In the third class we have the Indian Joint Stock Banks, of which 29 have paid up capital and reserves exceeding one lakh, while a very considerable number operate on a smaller basis. They are regulated by the Indian Companies Act. In the fourth class come the Co-operative Banks which seek primarily to supply credit to the agriculturists on joint liability, and so are sharply distinguished from the Joint Stock Banks, who deal principally in commercial credit. The Central Co-operative Banks in India and Burma number

about 500, while there is an apex bank, generally designated "Provincial," in nearly all the provinces. Controlled and largely financed by these are the primary societies of which there are now little, if any, short of 100,000. There is a special Act for co-operative institutions applicable to all India, save Bombay, which has its own Act.

The distinguishing features of the Imperial Bank are its position as the banker of Government, its management of the public debt, its function as a bankers' bank, with which most of the leading banks in India keep their accounts, and its management of the eleven Clearing Houses in the principal cities, through which transactions between banks are adjusted to save unnecessary transfer of funds. It is, however, permitted by its statute to engage in ordinary commercial banking business within defined limits, but is entirely prohibited from entering the foreign exchange business. Its paid up capital and reserve at the close of 1930 amounted to 11 crores, while it then held 7½ crores of public deposits (*i.e.*, Government funds) and 76½ crores of deposits placed with it by the corporations and persons who use it as their bank. (It may be as well to say here that I use the word "reserve" to denote the accumulated profits not distributed as dividends. In the United States these are called "surplus," and the word "reserve" is generally applied to the cash or sometimes the fully liquid assets which a bank holds for meeting its demand liabilities.) It has 102 branches, two more than the number which it was required by the Statute of 1920 to open in five years.

Of the Exchange Banks, the oldest dates back to 1853, and two others have had a life of 60 years. But the most striking feature of recent years has been the appearance of the Japanese banks in 1919, of the Dutch banks in 1921, and the American banks in 1922. The main business of all the Exchange Banks is the financing of the foreign trade of India, both imports and exports. They follow the former to the inland centres of large *entrepot* trade, and consequently have branches not only at the ports but at such centres. They do not, however, have much concern with the movement of Indian crops and other products to the ports, until they are shipped or are ready for shipping. The whole of the business of foreign exchange comes to them, as well as most of the import of bullion. They do a small amount of business in loans against securities and discounting of commercial paper. The total of paid up capital and reserve held by these banks may be put at about 250 crores of rupees, but of course this includes funds used for their very large business outside India. Their deposits from outside India amount perhaps to 1,700 crores, while they hold Indian deposits of about 70 crores. Assuming that the share of their "owned capital" available for Indian business is proportional to the share of deposits attracted in India, we may perhaps assign 10 crores out of 250 for Indian business.

The Joint Stock Banks, including the very small ones, have capital and reserve of some 13 crores, and hold deposits of some 65 crores. Their principal business is commercial banking, financing the movement of goods throughout India

and advancing against securities and to a limited extent against stocks in warehouses. Some of them advance against immovable property and occasionally lend to industrial concerns.

I have not been able to get really satisfactory statistics to illustrate the relative importance of Co-operative Banks in the general banking system. The collection of them is complicated by the fact that the three principal organizations, the Provincial Bank, the Central Bank and the primary society, finance one another, and thus deposits, paid up capital and reserve held by one appear again in the accounts of the others as part of the working capital. From a study of such statistics as are immediately available, it would seem that the total of the deposits held throughout India, after excluding transactions within the movement, is in the neighbourhood of 30 crores, while the "owned capital," *i.e.*, paid up capital and reserve, may be 15 crores. The movement commands some extra funds in the shape of loans from Government and cash credits from the Imperial Bank.

Thus, judging by their power to attract Indian deposits, the Imperial Bank, the Exchange Banks and the Joint Stock Banks stand upon a fairly equal footing, with the Co-operative Banks a good way behind. In all, the loanable resources of fully organized banks in India appear to be somewhere in the neighbourhood of 300 crores, of which about one-sixth is "owned capital." Seeing that the rural debt of this province alone is probably 155 crores, it is patent that organized banking still plays a comparatively small part in meeting the credit needs of India.

The next credit agency to be considered is also a true banking agency, the indigenous bankers, who not only lend money but also use the machinery of credit to supplement their private loanable funds, by attracting deposits or by drawing credit documents readily accepted and discounted in the money market. These our Committee decided to call by the old-established name of "shroffs" to distinguish them from money-lenders working entirely on their owned capital. Since they publish no accounts and for the most part engage in other business besides banking, it is impossible to present a picture of their activities based on trustworthy statistics. All the Provincial Committees have met with great difficulty in distinguishing "shroffs" from big money-lenders and consequently of reaching any clear conclusions as to the extent of their business, or even of their numbers. It is generally reported that shroffs are becoming fewer, except in Burma. Leaving that province aside, as a very rough estimate it may be that there are 1,500 shroffs in India, though probably not more than 100 confine themselves entirely to banking business. The amount of capital employed by them in that business is even more uncertain. As a guess I would put it at 75 crores, of which only 25 crores, if that, is derived from outside sources, and much of this is now from personal friends. There can be little doubt that the indigenous banking system, as represented by the shroffs, is less active than it was except in Burma and possibly in Madras. In contrast to the rest of India it may be noted that the Chettiars, who have come in from Madras, employ in Burma a capital of some 75

crores including some 53½ crores of owned capital, thus about equalling the estimate I have put forward for India proper. An interesting feature of Chettiar enterprise in Burma is the formation in 1929 of a private banking company with a paid up capital of 3 crores, which has gained access to the Rangoon Clearing House.

The features of the business of the shroffs are their willingness to take up business which the more rigid rules and conventions of western banking decline, elasticity and lack of formality in the conduct of business, and readiness to operate outside business hours observed in ordinary banks. The shroff is in modern slang "a good mixer." Their management is effective and economical, partly because it is in the hands of near relations, who already have an interest in it, or of employees who hope to acquire one by diligence and trustworthiness. The latter are employed in managing branch establishments, and are known as *munims;* such branch establishments are a well-developed feature of shroff banking. Though there is comparatively little formal organization linking the shroffs together, many of them are closely knit by family connections and mutual aid in difficulties is the general rule.

The shroffs perform all the principal banking functions, though operation on customers' account by means of cheques is rare. They have very little share in foreign trade, but a large one in internal trade. In that department they still work with *muddati hundis, i.e.,* accommodation bills drawn by the traders to be met after a definite

period usually 61 days. There is little use of real trade bills, drawn against definite stocks. The *hundis* are to some extent rediscounted with western banks, notably the Imperial Bank. This business must be distinguished from remittance business by means of *darshani hundis* (*i.e.*, sight bills) of which more hereafter.

They also operate in consumers' credit especially urban credit giving loans on house-mortgages, ornaments or merely on promissory notes. Their connection with industrial credit is mainly personal, *i.e.*, the investment of the capital of individuals in industrial enterprises, often involving a large share in their management. They do not appear to have any close connection with agricultural credit in most provinces, though it seems that in Bombay, Madras and Assam, they finance money-lenders, who in their turn lend to the cultivators. In Burma there is even greater and more direct connection. There is, of course, further the general connection with the agriculturist through the financing of both inward and outward trade.

There remains the entirely unorganised but still extremely important source of credit that is covered by the broad term "money-lending." At one end the personnel is only distinguishable from the *shroffs* by the fact that use of outside credit in the shape of deposits has been abandoned, often quite recently. At the other end we get the small cultivator who has saved a few rupees and lends them in the village, sometimes to his friends without interest. These and the money-lenders, whose activities range between the extremes, all play their part in the supply of credit, without which

economic life of the modern kind would cease, and so fill up the enormous gap between the resources of the organized bankers and the full credit needs of India.

What those needs are it is beyond my power to estimate. It can only be said that the several Provincial Banking Enquiry Committees have framed estimates of rural indebtedness which would indicate a total figure of at least 800 crores; that the annual produce of the land is probably worth at least 1,500 crores, and a large proportion (perhaps two-thirds) of it is marketed once and much of it twice or three times; that the annual imports of India in normal years are valued at some 250 crores and the exports at 330 crores. Then there is the very large amount of capital invested in the major and minor industries, the jute and cotton mills, the collieries, the iron, manganese, copper, mica and other mines, the tea gardens, metal and engineering works, oil mills, rice mills, sugar factories, electric supply companies, tramways and light railways and a host of other enterprises. Besides the fixed capital for the establishment of these industries, there is the capital required from time to time for their development or the replacement of their plant and the finance needed constantly for short periods to meet their current expenses. The railways have absorbed and still are absorbing a very large share of the available capital, while the past borrowings of the Government of India have built up a public debt of some 1,100 crores, to which have to be added the debts of the Provincial Governments and of the public corporations. Much of the credit, which is here involved is of a fixed charac-

ter, continuing with little variation in its total from year to year. But much again is fluid credit the liability for which is discharged in a few weeks or even in a few days, for example the credit involved in internal and foreign trade. It would be a tremendous task to determine with reasonable precision what amount of credit India requires during a year or any other period, but the figures I have given supply some rough indication of its immensity. Against this demand for credit, we have seen that organized banking including the contributions of the co-operative banks, the shroffs and the Chettiars, puts up at most a total fund of 500 crores.

No doubt much of the fixed capital has been supplied by private investors, both in India and abroad, as well as by foreign banks and investment companies, while trade requirements are met to a large extent from the private capital of the traders themselves. Still it is obvious that there is a very large demand for credit, especially that needed in the rural areas, which is left to be met by the money-lenders of all grades.

We may begin with the substantial urban money-lender, who is scarcely distinguishable from the shroff. They lend principally to traders and well-to-do consumers on some kind of credit document, *e.g.*, promissory notes, *hundis* or mortgages. The rest of the urban money-lending business is conducted by the pawn-brokers, often goldsmiths by profession, by amateurs of all classes, pleaders, salary-earners, small traders and artizans, and by the immigrant Kabuli or Pathan. These last deal mainly with the unfortunate

classes, who have never had any assets to support real credit or who have already pledged all they had.

In the far more important rural sphere of money-lending we find first the substantial rural money-lender, who treats it as his main profession, though he usually has a side line in trade on his own account or on commission. He is known in most parts of India as the *mahajan* or as the *sahukar,* and operates in a definite sphere within which he knows intimately the credit-worthiness of his actual or potential clients. He lends almost entirely to landlords and cultivators; first on their personal security, and then, if repayment is irregular, on movable or immovable property, obtaining ultimately such a hold on the land itself as the local tenancy law allows.

Next comes the smaller professional money-lender, who operates in a village or two and combines that profession with shopkeeping. He is known in the Hindi-speaking areas as the *bania,* and does business in much the same way as the *mahajan,* though on a smaller scale and with smaller clients. These two between them do most of the rural loan business of a professional character, though with them may be ranked as professionals the Kabuli or Pathan and other itinerant money-lenders, who in the villages as in the towns lend principally to those who have nowhere else to go for credit. But there is a general unanimity in the reports of the Provincial Committees that amateurs are becoming more and more important in the sphere of rural credit. These now include not only the landlord, who has

always played some part in the business, especially by making grain advances to his tenants, but the substantial cultivator as well, who has made a comparatively recent entry into the field. This is, I consider, one of the most important new facts brought out by the Banking Enquiry, and must colour any policy for the treatment of money-lenders that may emerge from that inquest.

To complete this hasty survey of the credit agencies of India, it is necessary to mention two classes, who, if they do not actually supply much credit, greatly facilitate its effective use. Of these the most important is the *arhatia* and the less important the *dalal*. Both operate solely in the sphere of commercial credit. The *arhatia* or *arhatdar* (Anglice, commission agent) is prominent throughout the whole course of inward and outward trade. He buys in the smaller markets on behalf of the larger urban merchants, or stocks in his golas on behalf of the seller till a buyer comes along, allowing the seller to draw up to 75 per cent. or more of the market value. In the inward trade he buys on behalf of retailers from the wholesale dealers of imported or manufactured goods. The *dalals* are purely brokers, whose business it is to bring together in the more considerable markets buyers and sellers of all kinds of commodities not excluding credit itself in the shape of *hundis*.

I will conclude this evening with a brief description of a function, which bankers have always undertaken and which is historically prominent in the development of banking. Apart from their main function of buying and selling credit,

bankers are employed in the very important business of remittance, that is to say the transmission of money or the command over money from one place to another. In undeveloped countries this is not easily distinguished from commercial credit, since goods take so long to reach their destinations and payments for them to return to the sellers that a considerable element of credit enters into the transactions. This state of affairs is perhaps responsible for the use in India of the same word *hundi* at once for a document intended to give credit for a substantial period of time, and for one intended primarily to save the risk and expense of transmitting actual currency. Be that as it may, nowadays, with rapid communications, internal remittance is effected with a very small element of credit attached to it.

The most primitive form of remittance is, of course, actual carriage of currency by a principal or his employee from one place to another. This is still the practice in many parts of India, where hard cash is required for the purchase of rural products, or the payment of labour, and where there is nothing in the nature of a bank to aggregate and re-issue currency. It is also still necessary for banks to some extent to move currency from one branch to another, and, still more for Government treasuries to do so in order to draw off the surplus influx at one place to centres, where it is at the moment required. One still sees on railway platforms a guard of armed police in charge of treasure boxes (I saw them yesterday at Gaya), though it is, owing to the greater use of other methods of remittance, a far less common sight than it was 30 years or so ago.

The next stage is to entrust to a well-regulated agency the business of remittances of actual currency, and this is an important function of the post office. The transmission of currency notes by insured post is the common method of supplying the means of purchasing agricultural products, such as grain or jute, to their local agents by large exporters or users of the raw material. The recent attempt to discourage transmission of cut notes, by making it more difficult to obtain refunds in case of loss, has been widely criticised by traders. The post office also does a very considerable part of the total remitttance business by means of money orders, and some too by the value-payable post, both methods of transmitting not money itself but the command over it. The money order is the main and, in fact, very nearly the only method of remittance used in the rural tracts, and is of immense service to all classes, who are obliged to seek their living at a distance from their homes. Government, too, directly provide facilities for remittance of substantial sums by means of supply bills and currency telegraphic transfers from or to a place, where there is a Government treasury but no branch of the Imperial Bank, and these facilities are somewhat freely used by merchants operating in such places.

The Imperial Bank remits on behalf of its customers between places where it has branches by means of bank drafts, which are practically identical with supply bills and charges as a rule the same rates as Government does for supply bills. It gives a lower rate to Joint Stock Banks

1420

at places where they have current accounts with the Imperial Bank.

The Joint Stock Banks do not get a great deal of the remittance business, since the bulk of their branches are at places where the Imperial Bank also has a branch. They use the concession rate given to them by the Imperial Bank to remit on behalf of their own customers, making a small profit thereon. The main business of remittance, excluding the share of the Post Office, is with the shroffs and merchants, and is conducted by means of *darshani hundis* (sight bills of exchange). These are in most considerable trade centres easily bought and sold, and the cost of remittance is ordinarily reduced below the rates payable to the Post Office or the Imperial Bank, and even at times give a premium to the remitter. In fact on the balance the cost of remittance by this means is scarcely more than the remuneration of the *dalal*, who brings together those who want to remit and those who hold or are prepared to create *hundis* on the destination of remittance. It is not even necessary to secure a *hundi* on that destination, since *hundis* are often negotiated between two smaller centres of trade through a large one such as Calcutta. The *hundi dalals'* brokerage is very small, one or at most two pice per hundred rupees, since he has no place of business or office expenses, doing his work on the street. Remittance by means of *darshani hundis* is not however available in the smaller trade centres, where the more expensive agency of the post office has to be called in.

Of the total amount of internal remittance required it would seem, if the position through-

out India is not widely dissimilar from that in Bihar and Orissa, that the post office handles the largest amount of business, closely followed by the shroffs and traders, with the organized banks a bad third.

I here close this very rapid survey of all-India banking and kindred activities. The principal facts that it seems desirable to emphasise are—

(1) that the existing banking organization is very far indeed from filling the role it fills in other countries. For example the owned capital of banks of western type is probably barely 50 crores, while in the United States it is nearly 4,000 crores. Deposits may be put at 250 crores, against a figure for U. S. A. of nearly 8,000 crores. Deposits in British Banks may be put at 2,500 crores and owned capital at 200 crores,*

(2) that commercial credit is the only form of credit in which the organized banks play an important part;

(3) that the indigenous bankers, or shroffs, still occupy a considerable

*In 1929, the owned capital of the Federal Reserve Banks was 110 million dollars, and that of the Member Banks 10,000 [illegible]llars. The figu[illegible] deposits were 250 million dolla[illegible] [illegible] 2,100 million dollars respectively. It is estimated that ba[illegible]s which have not [illegible] into the Federal Reserve System, [illegible]ne-fourth of the banking capital of the United States a[illegible] [illegible] about the same proportion of the deposits. The figures [illegible] British banks [illegible] based [illegible] a deposit total of £1,780 [illegible]llions, and an owned capital total of £134 million for banks us[illegible]g the London Clearing [illegible] The report November, 1928.

part of that field together with western banking institutions, though their business is decidedly on the downward grade;

(4) that, except for the growing but still relatively slight activities of co-operative banks, organized banking scarcely reaches the rural areas, which depend for their credit on unorganized money lending. This statement requires the qualification, that organized banking does assist materially in the movement of rural produce;

(5) that the indigenous banking is largely out of touch with organized banking, and its connection with rural money lending is slight, though its activities in rural trade are considerable;

(6) that remittance is fairly well organized and that indigenous methods of remittance still play an important part. But it is likely that the cost of remittance, of which traders generally complain, could be substantially reduced by better organization.

LECTURE II.

The Credit Needs of Bihar and Orissa.

In yesterday's lecture I gave a sketch of the banking and other credit agencies of India as a whole. To-day I am beginning to examine the credit problems of Bihar and Orissa, and intend to put before you a picture of the extent to which credit is in demand in this province, reserving for my third lecture the discussion of how that demand is met.

The credit needs of Bihar and Orissa may be divided into those of the rural, which is mainly the agricultural, population, those of the trading community, those of the industrialists, and those of the remainder. The rural population according to the 1921 census was $32\frac{3}{4}$ millions out of a total population of 34 millions. Nearly two-thirds of these are ordinary cultivators, and it is the credit which they require that forms the main banking problem of the province. Of the rest some five million are field labourers or farm servants, some two million miners or other industrial workers, and about one and a quarter million are traders, or are engaged in transport. Landlords and their agents contribute half a million, and foresters, stock raisers, fishermen and hunters about the same number, while another half million are engaged in public administration or in the liberal arts. Of the rest about one million are unclassified labourers living in the villages.

These broad distinctions of the census need some elucidation. The ordinary cultivator is a person,

who derives his living mainly from growing crops, but he may also receive rents from other cultivators, engage in subsidiary industries, trade in or cart produce. Of the industrial workers the great bulk are the village weavers, potters, smiths, barbers and carpenters, the women who husk paddy and so on. It will probably surprise most people familiar with the province to learn that, judged on the census definition of an industrial worker, Cuttack is the most industrial district, while Puri comes third. Again "Public administration and the liberal arts," while it suggests venerable statesmen, learned judges, magistrates and counsel, skilful and untiring surgeons and physicians, inspired poets and painters, actually means for the rural areas, chaukidars, temple priests and servants, and midwives. Thus those of the rural population, who are not classified as ordinary cultivators or field labourers, do not, in the main, differ very markedly from them in their standard of living or their general economic needs. Many of them depend partially on actual cultivation, and for most of them success or failure of the main crops spell prosperity or depression in their own occupations. Consequently the problem of rural credit is primarily that of financing the agriculturist.

The investigations of the provincial Banking Enquiry Committee point to a figure in the neighbourhood of 155 crores as the indebtedness of the rural population of this province, at the time of year when the demand for credit is strongest, viz. the months of September, October and November, just before the new rice begins to find its way to market. Of this some 24 crores is owed by the substantial landlords, about 2 crores by the landless classes, and about 129 crores by the

ordinary cultivators. There is no reason to believe that there are strong seasonal fluctuations in the indebtedness of the two former classes, but it seems likely that about 25 per cent. of the ordinary cultivators' debt is regularly incurred and repaid during the year, and consequently by May, when both the rice and rabi harvests have been got in, the total debt has fallen from 155 crores to 123 crores. The balance of 32 crores will be wanted again as the year advances and is probably reabsorbed by September in a normal year. But it must of course be understood that a good harvest will both diminish what may be called the fixed debt and decrease the demand for annual borrowing, unless, as is unfortunately the case this year, prices have fallen rapidly. It is scarcely necessary to add that a bad harvest will increase the demand for agricultural credit. Other causes operate such as exceptional expenditure on marriages, a feature generally reported last spring, as a consequence of the inception of the "Sarda" Marriage Act.

The next point to be examined is the purposes for which this indebtedness is incurred and renewed. The landlords numbering about 58,000 households, owe something like 24 crores, or about Rs. 4,200 per household. But half of them are not indebted at all, and consequently the average indebtedness of encumbered landlords is probably about Rs. 8,400. There has been no formal enquiry into the objects of landlords' borrowings, but all, who have been brought into touch with estate management, will probably agree that the main purposes are the gratification of their personal tastes, including particularly the maintenance and

enhancement of their social position. Instances are common of a zamindar, already indebted, buying an elephant, because a richer zamindar had got one. I recently found half the year's income spent on the wedding of a sister and even more inordinate displays of family affection occur. It is obvious that, since only 3½ lakhs had been taken from Government in the last 5 years as Land Improvement loans, a wholly insignificant part of the indebtedness of this class is for productive purposes.

The two million rural households, which are neither landlords or raiyats, have been put down as owing Rs. 10 each. This is a mere estimate and no real justification can be given for it. A very considerable proportion of them, the field labourers, farm servants and unskilled manual labourers are ordinarily without credit-supporting assets, though now and again some fall victims of the itinerant money lenders. Others in backward districts are in nominal debt to their employers, under the system against which the Kamiauti Agreements Act was directed. Their borrowing is mainly for subsistence, and occasionally for social ceremonies, and can scarcely be worked into any banking system. But within the group come the village artizans, whose position as part of the industrial framework of the community is important. At present, however, information as to their finance is lacking. It would seem likely that most weavers are indebted to the extent of the cost of their yarn, while smiths owe for their raw materials. The others are probably free from debt in ordinary times, but borrow occasionally for social ceremonies or when want of purchasing power among their neighbours makes their products unsaleable in the normal market for them.

There remains the great bulk of the rural population, the ordinary cultivators, who in this province are decidedly better off than they are in most parts of India by reason of tenancy laws, which secure to them permanency of tenure and protection against rack renting. These benefits give to the cultivator assets to support credit, though where they are supplemented by something approaching a freedom to transfer his rights, they may tempt him to overstrain his credit resource. As we have seen, the ordinary cultivators, who amount to some 4½ million households, owe some 129 crores at the peak season and some 97 crores, when the harvests have enabled them to reduce their debts to a minimum. Taken throughout the year the mean debt is 113 crores, or about Rs. 266 per household. The greatest indebtedness is found in Bihar proper where the mean may be about Rs. 385 per household. On the Chota Nagpur plateau it is only Rs. 122 and in the Orissa coast districts only Rs. 112. In each case the maximum and minimum of the year ordinarily differ from the mean by about one-eighth of that mean. It may, however, be remarked that of every hundred households 27 are free from debt, and 40 owe less than Rs. 100. It is the remaining one-third, who constitute the main problem of agricultural finance, roughly 1½ million households carrying a debt of 100 crores of rupees.

The purposes for which the ordinary cultivator borrows are—

(i) for growing his crop, including the provision of food, clothes and shelter for himself and his family during the process, as well as the payment of rent;

(ii) for the upkeep of his equipment of live and dead stock in an efficient state and for improving his farm and stock;

(iii) for social ceremonies;

(iv) for extension of his business by purchase of land and for trade, as well as for defending his property in the courts;

(v) for paying the interest on his debt or for repayment of the principal.

Such statistics as the Banking Enquiry Committee were able to collect point to the following distribution of the maximum debt of 129 crores, though much more evidence is required to render them secure. About 39 crores has been taken to repay earlier debts or to meet the interest on them. For social ceremonies about 26 crores has been borrowed. Thus about half the debt is clearly unproductive. Something like 16 crores has been taken for maintenance, house building and repairs, of which perhaps 5 crores have been spent on building and repairs of houses, leaving 11 crores for maintenance. Rent and cultivation account for 9 and 10 crores respectively. Thus 30 crores of the total debt has been borrowed for needs which are likely to recur annually. Perhaps 15 crores has been borrowed for upkeep of farm stock and improvement, and the remaining 17 crores for trade, purchase of land and litigation. For litigation the borrowing is far less than is generally believed, and it probably does not account for more than one to one and a half crores. Borrowing for trade is important and probably increasing, especially in Bihar proper. As will be seen later the raiyat has

nominally to pay about 20 per cent. on his borrowings. Thus in order to preserve but not improve their economic position, the raiyats will have to find on the harvests 26 crores for interest alone besides 32 crores for repayment of their annual borrowing.

We are now in a position to make a tentative estimate of the finance required by the rural population, other than that required for regular rural trade, dividing it into short, medium and long term accommodation. "Short" means repayment in the year of borrowing; "Medium" in a period ranging about five years, and "Long" in a period ranging about twelve years. In making this estimate the points to be remembered are :

(1) that the total indebtedness is taken at 155 crores maximum, viz., 129 crores among ordinary cultivators, 24 crores among landlords, and 2 crores among others; and

(2) that the ordinary cultivators borrow and repay about 32 crores annually.

The short term debt may be put at 21½ crores assigning 20 to cultivators, ½ a crore to landlords and 1 crore to others. The medium term debt may be put at 34 crores, 30 owed by cultivators, 3 by landlords and 1 by others. This is repaid over an average period of five years. The long term debt may be put at 100 crores, 79½ owed by cultivators and 20½ by landlords. This is repaid over an average period of twelve years. Thus the cultivator repays 20 crores of short, 6 crores of medium and 6 crores of long term debt annually or 32 crores in all. The

landlord repays $\frac{1}{2}$ crore of short, $\frac{3}{5}$ crore of medium and $1\frac{3}{5}$ crores of long term debt or 2,70 lakhs in all annually. The rest repay 1 crore of short and $\frac{1}{5}$ crore of medium term debt, or $1\frac{1}{5}$ crores in all annually.

This gives an annual repayment (and assuming a static position of indebtedness) an annual borrowing of some 36 crores. It may also be noted that the long term debt, which must be largely covered by registered mortgages, is put at 100 crores, against a total amount shown as borrowed in such a way by the Registration Department of 66 crores in the 10 years, 1919 to 1928. The cultivators' long term debt is a little over 60 per cent. of their whole debt. But the Banking Enquiry's statistics suggest that only 40 per cent. of their whole debt is covered by registered mortgages, which would leave one-third of the long term debt not so covered. The landlords' long term debt has been taken as all covered by registered mortgage, and to be about 85 per cent. of their whole debt. If these figures are right then 72 crores of rural debt is covered by registered mortgage, against a probable accumulation of about 80 crores of mortgage debt in twelve years.

Figures have already been suggested for the apportionment of the cultivators' debt to purposes. If the estimate just given is correct, it would seem that about two-thirds of the debt incurred for maintenance rent and cultivation which has been put above at 30 crores is repaid in the year. The rest, together with all the social ceremonies debt, and about two-thirds of that incurred for improvement and upkeep of stock and house,

purchase of land, trade and litigation, falls into the medium class. Finally the repayment of old debt and interest accummulation, as well as the remaining third of that taken for improvement, upkeep, etc., make up the long term class.

I must repeat the warning that this estimate is tentative and depends on the accuracy of the Committee's estimates of the total indebtedness, the annual borrowing, the proportion of secured to total debt, and the period adopted here for the time taken to repay secured debt. The first two have a fairly sound statistical basis: the last two certainly require a much more thorough investigation, which I commend to economists. All I can say is that the estimate seems to fit the available statistics and any attempt to modify them, and I have tried several, leads to greater difficulties. If the estimate is approximately correct it reveals one very serious feature, which is that only two-thirds of the borrowing by cultivators for maintenance, rent and cultivation can be repaid on the harvest of the year. It is difficult to see how a postponement of repayment for these essentially short term borrowings can avoid increasing the burden of debt. It is also disturbing, if true, that cultivators are unable to pay off mortgage debts sooner than twelve years after their creation. I propose to deal with these problems more fully when I come to the part which co-operative credit plays and can play in rural credit.

The next problem to be examined is the finance required for the trading community. To a small extent this overlaps the rural population's problem since some of the cultivators' debt is undoubtedly incurred for trading purposes. But though this is

increasing, I am inclined to think it is still relatively unimportant.

The first part of the problem is to estimate what sums are needed for the process of getting the agricultural and other products of the province, other than those required by their producers, into the hands of the consumers, and for how long those sums have to be utilised. The second point is to make a similar estimate for the reverse process of supplying the producers with the commodities they need.

Let us first examine what the first process broadly is. It begins for agricultural products at the village, where the cultivator, after putting by the stock required for his household and for seed, parts with the balance to a trader or starts in with it to the nearest market. It would be interesting to get some more information of what proportion of the principal staples is sold in the villages and what proportion is brought in by the cultivator to the market. Both methods of first sale are common enough. One meets on the roads the string of raiyats and their womenfolk with their *bhangi* loads and headloads as well as the *bepari* with his pack pony or bullock. Every landlord who collects market dues from the transactions carried through on his land prescribes the toll for either method of bringing goods for sale. The primary markets or *hats* are to be found throughout the province about six miles apart, a spacing which is no doubt imposed by the inconvenience of carrying a heavy load more than three miles or so. In England market towns occur about every ten to fifteen miles which was the convenient spacing for the use of a horse and cart over the bad roads of the period when most of these towns developed.

The *beparis* who buy in the villages are not necessarily or even ordinarily strangers. Frequently they are the more substantial raiyats themselves, but the village money-lender probably still does the bulk of the business. In the *hats* of more backward areas much of the trading is still done by barter, a measure of paddy being exchanged for a small quantity of salt or spices. The first point to be emphasized in this branch of trade, which is more properly designated marketing, is that the sellers are almost invariably small men with little to sell. They are compelled to sell fairly briskly as soon as the harvest is in to pay off creditors including the landlord with his demand for rent, but they continue selling for a considerable part of the year to supply themselves with day to day needs. The buyers at this stage are also small men, who use their own capital supplemented to some extent by advances from the larger men, who operate at the next stage.

Of the products that come into the *hats* a good deal passes into consumption at once. The rest goes forward to the bigger marts, which in Bihar are to be found at intervals of every 15 miles or so. These are generally provided with some warehouse accommodation where grain can be stored. Here the more considerable traders come in, buying either on their own account or for the big merchants of the principal towns, from the smaller traders who have collected the commodities in the *hats* or brought them direct from the villages.

Lastly in the few large towns of the province there is something like a fully organized market, where the merchants, who buy for export from the

province or for urban consumption have their warehouses fed from the purchases of their own agents or others at the country marts.

This is a general description of the course of marketing of the principal staples such as rice and other food grains, the oilseeds, etc. Special commodities of considerable importance have somewhat different courses of trade. Thus much of the sugarcane goes straight to the factories and is sold as sugar outside the province. What is locally crushed and sold as *gur* either goes straight into consumption through the *hats*, or is collected by *beparis* who move it into Bengal. Tobacco is mainly sold to *beparis* in the villages and taken direct to comparatively few places for manufacture. The bulk of the stick lac is bought up in the *hats* by small men called *paikars,* trading mainly on borrowed money on their own account, and resold through substantial *arhatias* to the factories.

A very rough estimate of the value of the rural commodities that pass through the three stages of marketing detailed above is to be found in the Report of the Banking Enquiry. This gives a value of 75 crores as the annual transactions in the 2,500 *hats,* as well as sales to *beparis,* who take their purchases direct to larger markets. The annual trade of the 432 intermediate markets is put at 50 crores, and that of the genuinely urban markets at 25 crores. I do not claim any high degree of accuracy for these figures, which of course must vary somewhat widely with fluctuations both of production and price, and it would be a very valuable study to test them by detailed enquiries at a number of markets of each kind.

Clearly though the value of the commodities handled in the process of marketing is not very different from the total debt of the rural population, the problem of financing is quite dissimilar. For the rural debt what is wanted is capital for lock-up investments of about 100 crores, further capital, which is turned over in the average once in five years to the tune of 34 crores, and lastly fluid capital of 21 crores, which is placed out on loan for some three to nine months.

The finance for marketing the crop is of course of a much shorter term. Some, though not, our enquiries led us to conclude, a very considerable proportion, is used for making advances on the crop with the condition that it will be handed over to the money-lender and its value set off against the loan. This is included in the rural debt. The great bulk of the first stage of marketing is, however, carried through on a cash basis. In so far as the commodities are at once taken into consumption the matter ends and there is no appreciable use of or demand for credit. It is, in fact, generally speaking only for that proportion of the commodities that go forward into the second stage of marketing, *i.e.* are dealt with at the larger country marts, that credit is required. The people, who buy in the villages or at the *hats* for resale at the intermediate marts, want either owned capital, or command of capital by use of credit, for the period between their purchase and their sale. This must be at least as long as the time taken to get the commodities to the intermediate marts. It is usually a little longer, since there will be, as a rule, some stock carried over unsold from one market day to another, and left in the golas of *arhatias*

to be sold off on commission account as opportunities occur. At the third stage, where the big merchants come in, credit is more generally required and a longer period necessary. The commodities are purchased at the intermediate marts and conveyed, often from considerable distances, to the urban markets. The purchaser trading on his own account will usually want credit to cover his fairly considerable transactions, while if the purchase is made by an agent of a big merchant, he will have to be kept in funds. There is by no means a steady sale of the produce at this stage, a fact of which merchants are no doubt painfully aware in the present prevalence of unexpectedly low prices. And in any case the procuring of railway wagons, loading thereon and conveyance to destination all occupy time, and so create a demand for credit. I put forward, then, very tentatively that scarcely any credit is required at the first stage of marketing, about 15 days' credit on the average at the second, and about two months' at the third.

Coming to the other side of the picture, in the supply to consumers, mainly rural, of the commodities they require, *i.e.*, inward trade, the process for several of the most important commodities is similar though reversed. Thus cloth, and salt, as well as, for areas that do not grow their full supply, food grains are bought by the big merchants in the towns, sent out for resale at the intermediate marts and finally sold to consumers at the *hats*. (There will of course be some take off by local consumers at each stage). There is, however, a somewhat important difference in that the share of this trading done on a

commission basis is much greater than it is in outward trading. It is natural that agency, rather than individual, trading is more prominent, where the commodity starts in bulk and is gradually divided up into single purchases, than where the commodity has to be bought in small parcels and accummulated into bulk. The period of the credit required to carry through the trade is probably somewhat shorter, since the commodities pass into consumption in a time which is sensibly shorter than that in which the surplus agricultural products take to find their markets. The big importing merchant, who buys cloth for instance, can cut down replenishment, when sales are falling off, whereas if the outside demand for surplus produce of the countryside slackens, the stock has to be held somewhere, as producers and dealers in jute and lac and in many other rural products know only too well at the present moment.

In attempting to estimate the credit, both in money value and period of time, required to carry through the inward trade of the province, it has to be remembered that a very considerable portion of it goes straight from the outside supplier to the ultimate consumer. This short-circuiting of the process is found, too, in the outward trade, for example, nearly all our coal is sold straight from the colliery to the consumer. But the proportion of the total value of commodities so handled is probably much higher in the inward trade. Indeed there is some tendency even in such staples as cloth, to cut out intermediary stages, and the function of certain of the larger towns as distributors for the retail trade over a large area is becoming less important, since the smaller centres are

now indenting directly on the sources of supply. The very important trade in kerosene and petrol is mainly organized on the direct supply system.

Another important point of distinction between inward and outward trade is that the former is fairly uniform throughout the year, while the latter is subject to a decided seasonal tide. Salt, spices, kerosene and many other commodities are constantly required by consumers in small quantities. Their small bulk for value enables them to be moved freely out to the ultimate consumers even when the monsoon renders country roads impracticable for wheeled traffic. But the chief commodities of outward trade, the food grains, oil seeds and so on are bulky and for the most part have to reach at least the intermediate marts in the drier months. Further their producers are in need of ready cash to meet the demands of their *mahajans* and landlords, and consequently there is a much larger movement of commodities in the periods immediately following the harvesting of the principal crops than at other times of the year. This is the cause of the great demand for commercial credit during the early months of the calendar year with a slackening in the later months. I do not know of any attempt to estimate the value of inward trade, which goes through the various stages of marketing within the province. It would be interesting at least to know how far there is a balance of transactions in the *hats* and intermediate markets, *i.e.*, whether the sales of country side products are approximately equal to the purchases of goods brought in from outside.

We have considered on broad lines the volume and nature of credit required for rural

production and for outward and inward trade. There remains the credit needed for industries of the province and for consumers.

The industries of the province may for our purpose be divided into three; large scale and fully organized industries such as the principal collieries, the iron ore, manganese and copper mines, iron and steel works, engineering and cement works, and sugar and indigo factories: the organized industries on a smaller scale, *e.g.*, the smaller collieries and engineering works, mica mines, limestone and kaolin quarries, the lac and silk factories, the oil, flour and rice mills, the tanneries, saw mills and printing presses; and lastly the cottage industries rural and urban, of which by far the most important is weaving.

This classification of industries will be found to be useful when we come to deal with the manner in which their credit needs are met. At present we are concerned with analyzing those needs. Industries require three kinds of credit, though the importance of each kind necessarily varies with the scale and the nature of the industry. Firstly there is need for fixed or block capital at the inception of the industrial venture, to obtain land for premises, to erect buildings and plant for manufacture, and often to secure command over the raw material. For these purposes really long term credit is required and is usually obtained either from the private savings of those interested in the venture or from the general public by flotation of a company and issue of shares. Secondly most industrial concerns of any magnitude require capital for improvement of equipment or expan-

sion of business, which should be capable of repayment out of the profits accruing therefrom within a comparatively short period. This may be called "debenture capital," since it should properly be met by terminable loans. Lastly practically all industries require short-term credit to meet their day to day needs, for payment of wages, for purchase of raw materials, and for marketing their products.

Let us examine this in concrete instances. A new colliery is to be opened. The first business is to secure from the owner of the mineral rights a lease, which gives power to extract the coal and to use the surface for buildings, tramways and so on. For this the company will usually have to pay a lump sum down by way of *salami* as well as agree to the payment of a royalty on the coal extracted. Then there will be buildings to be erected for protecting the machinery and for housing the staff and the labour force, the machinery itself to be purchased, the tramways to lay down, a siding to the railway line to be constructed, probably a water-supply to be provided, and certainly large expenditure on sinking pits, driving inclines and galleries or removing the overburden from quarries. Most, if not all, of these charges are to be met from fixed capital, which will remain as a charge on the profits of the colliery throughout its life-time. Later there will come a time for replacing worn or out-of-date machinery or for extending operations by sinking another pit or providing housing for a larger labour force. It may be possible to meet such charges by reserves accumulated in a few years of prosperous working, or it may be found more

advisable to borrow for a fixed term in anticipation of repayment from profits, in the shape of debentures. Lastly throughout its working the colliery will be in need of funds to pay wages to the labour, royalty to the original owner, rates and cesses to local authorities and a host of other expenses. These will of course ultimately be met from the sales of coal, but will occur at irregular intervals and frequently need the use of credit.

Similarly to take an instance from the medium-sized industries. A lac factory will require some initial outlay on premises and the erection of the comparatively simple apparatus for crushing and washing the twigs that carry the stick lac and for melting it out into shellac. Its expenses for replacement and expansion when business is brisk will be on an equally modest scale. But its short credit requirements will be of far greater relative importance than those of a colliery. To secure anything like a regular supply of the raw material the factory will have to buy largely during the two principal and two subsidiary periods of the year, when fresh stick lac is coming on the market. It usually does that from *arhatias*, who make their purchases locally through their own agents or more usually through smaller dealers called *paikars*. But it is the factories that have to supply much of the cash required for paying the raiyats, who bring the produce of their trees to the *hats*, and it is they who have as a rule to find the credit to carry over till the shellac is manufactured and passed on to the exporters in Calcutta. The small importance of block or "debenture" capital in this industry compared

with the requirement of short term accommodation is responsible for the fact that, when shellac prices are high, very small men, such as the tailors of Jhalda, temporarily become lac-manufacturers, paying high rates to those willing to lend them the money needed for buying the raw material.

Lastly we may examine the case of the cottage industries. The great majority of these require no use of credit at all, except of the kind which is practically consumers' credit, *i.e.*, the borrowings to maintain the worker and his family during slack times. In this respect the rural cottage worker is hardly distinguishable as an industrialist from his neighbour the agricultural labourer or very small cultivator and indeed the two classes overlap. Of such, are the village blacksmiths, carpenters, tailors, barbers, washermen and thatchers and the women who husk the paddy for rice. As a rule their customers supply them with the opportunity of exercising their profession and they need no capital but a few inexpensive implements for its exercise.

Coming a little higher in the scale of credit-users, we find the potter needs a few rupees a year to secure a source of suitable clay, the *pasi* has to rent the palm trees to which he attaches his toddy-pots, the tanner has to pay a royalty to the landlord for the right to collect his hides, while the weaver and the brass or other metal workers have to keep themselves constantly supplied with their raw materials and spend more on their implements. Oil-pressing in the villages is often something like a joint-stock industry with wooden presses hollowed out by the patient

labour of those who use them or their ancestors. I have a pleasant recollection of the pride with which a Munda village showed me a stone oil press, that one of their forefathers had cut single-handed. He must have spent most of his lifetime on it. Cane-pressing, still a very flourishing subsidiary industry in spite of the organized sugar factories, is also on a joint-stock basis, several small men, who grow a little cane, clubbing together to hire, from itinerant dealers, the presses and the boiling pans needed to convert the cane into *gur* or *rab*. But though industrial workers of these kinds comprise at least 6 per cent. and may be 8 per cent. of the population of the province, their credit needs are not commensurate with their numbers, and arise, for most of them, only when failure of the harvest restricts the demand of their customers.

There remains credit for consumers, or perhaps it would be more correct to say for that part of the population that is not engaged as principals in agricultural or industrial production or in trade. The largest class so comprised is that of agricultural labourers, who as long as they stay at home command only an insignificant amount of credit, and have to pay heavily for it when they need it. Their outlet is emigration to the centres of organized industry, especially the coalfields within the province and the tea gardens of Assam. In both the demand for labour is great enough to allow of considerable expenditure on recruitment, and part of this takes the form of advances to the labourers themselves to clear off their debts or to keep their families during their absence. These advances, made by colliery contractors, are rarely

less than Rs. 20 and sometimes reach Rs. 100 per head. Similar advances are made to get recruits for the tea gardens and in both cases are worked off in a few months at a higher scale of wage than the recruit can earn at home.

From a banking point of view, though not I think from a sociological point of view, far more important are the borrowings of the landlord class. It has been already said that the landlords, as a class defined by the right to vote on that franchise in the Council elections, comprise about 58,000 households and owe about 24 crores of rupees. This gives an average debt of some Rs. 4,200 per household. No doubt some of this is due to causes, which could not have been avoided, but, as I have said before, anyone who has had any experience of estate management in this province will testify that most of it is unproductive debt incurred by expenditure out of all relation to income, on personal gratification and display. Most of the credit supplied to this class is actually or tends to become long term credit. It is a serious question whether it is not to the permanent lock-up of this very considerable share of the savings of the community that the high rate of interest, which hampers the development of industry and the course of trade must be largely ascribed.

The only other considerable kind of miscellaneous credit demand is that which emanates from the professional classes. Here, though to some extent social customs still lead to excessive expenditure, most borrowing is for tiding over temporary falling off in earning power or for education of the rising generation. The records of such insti-

tutions as the civil service, postal and *amla* co-operative societies would probably throw light on the volume and period of such credit. My impression is that some 100,000 households owe Rs. 50 each on the average, making half a crore in all, and that most of the debt is short or medium term.

As a mild stimulant to future economic studies and perhaps at the risk of being found widely wrong, I will make an attempt to estimate the annual credit requirements of the province. I would put the rural credit needs, excluding trade credit at 37 crores, but of this perhaps 10 crores is required for six months only, and the capital used to meet it is available for other purposes, especially trade, from, say, February to July. Thus for an annual estimate 32 crores would be the proper figure. For dealing with the 50 crores worth of annual outward trade at the intermediate markets, where credit of 15 days may be needed. some 2 crores will be required, while for the 25 crores worth that comes to the urban markets, some 6 crores will be required. We may perhaps assume that an equal amount of credit is needed for inward trade, and so put down 16 crores as the annual trade credit needs.

For industries our Report has put forward, with I may say considerable diffidence, a figure of 30½ crores as the fixed capital invested. Of this probably 25 crores comes from outside the province. We have also roughly estimated that in ten years' time a further investment of 5 crores fixed capital in the medium sized industries such as sugar factories, oil, rice and flour mills, electric schemes, mica mining and manufacturing, printing, lime

works, cigarette factories and so on might be expected. At the moment that estimate certainly looks optimistic. But over a long period, which we may hope will include a boom as well as a slump, it might well be that each year half a crore of new money may find a profitable investment in industrial development of the province, including replacements needed for existing industrial enterprises. This excludes the heavy industries, coal, iron and so on, which have hitherto been mainly financed from outside the province.

Urban consumers' credit is the only other demand on the credit supplies, except borrowing by the State itself and by public bodies. There are only 300,000 urban households, and a very large proportion of these probably do not require consumers' credit, though they use credit for trade purposes. Urban consumers' credit is largely confined to the very poor, and consequently it is doubtful whether it makes relatively and appreciable demand on the available supply.

State borrowing and the borrowing of public bodies make a much more important inroad on the available capital. The Government of India public debt stands somewhere in the neighbourhood of 1,100 crores, and of this Bihar and Orissa investors, either private or the banks operating in the province, must hold a share. Assigning to the province the deposits collected therein by banks that have branches in more than one province, and applying the known proportion of total deposits to gilt-edged securities held, it may be presumed that the share held by the banks is something between one and two crores. The shroffs

and the general public probably have a much more considerable holding. Perhaps we may say that ten crores is invested in public funds.

I am trying to seek a figure for the amount of capital turned over during the year, a kind of entity in two dimensions of which one is *value*, expressed as currency or command of currency, and the other *time*. We know into what difficulties the conceptions of dimensions may lead us, from the researches of up-to-date physicists. And I am not quite sure whether economists will not find their painfully won solid ground disintegrating under their feet, in much the same alarming fashion as that which the physicists have lately experienced. " Panta rei " is perhaps as good a starting motto for economists as for physicists. But let us seek a " pou sto ", even if it is only relatively at rest.

I would on the basis of the sketch I have already given put the credit needs of Bihar and Orissa at somewhere about 50 crores of rupees turned over once in a year, that is to say that, somewhere within the province, there should be some persons with sufficient credit resources to lend to others a sum of sufficient magnitude for such period or periods of time, as would be equivalent to an instantaneous delivery of 50 crores to the people who need it, with the assurance that they will not be required to restore it to their creditors till twelve months have elapsed.

LECTURE III.

The Credit Supplies of Bihar and Orissa.

In the last lecture we were considering the provincial demand for credit, its volume, its period and other characteristics of the several subdivisions which make it up. At the end of it I put forward the idea that it could, if adequate knowledge were available, be measured by a definite amount of value available for a definite period, and I put the value at 50 crores for a period of one year. If there is any future at all for such averaging of economic quantities, and for subjecting them, like mechanical, electrical and other physical phenomena to the discipline of the rod and the clock, I trust that none of my audience will go away with the impression that the figures I have suggested have any sort of finality. To begin with we are now assured by the most eminent physicists that the standards of measurement of length are themselves relative, and that a metre rod is apt to be short of its tally if it happens to be moving in a particular direction, and possibly even time has similar idiosyncracies. We need no such refinements of experiment and thought as those of Michelson and Einstein to bring home to our consciousness that one, at least, of the standards of economic measurement, I mean of course value, has a relative character, and its relativity is emphasized, when it appears as money.

At the same time value as measured in money does not nowadays vary so enormously or so rapidly that it is entirely futile to compare a demand for credit with the ascertainable means for meet-

ing that demand. If, by a fall in prices, money values are depreciated all round, the money value of the available credit stores is affected, comparably though not immediately, equivalently witn the money value of the demand for credit. The adjustment is not, unfortunately, as perfect as it is in the physical world, where apparently only one human being in a hundred million can discover the need for it, but it is still not impossible to make. Hence I think it is not wholly absurd to attempt to estimate what part of the assumed credit demand of the province is capable of being met by organized agency, what other agencies are at work in meeting it, and what machinery is employed in the process.

I may say at once that it is well known that the agencies for meeting credit needs in Bihar and Orissa are, as I have already indicated in discussing the all-India problem, largely extraneous to organized banking. I intend in this lecture to attempt to estimate how far they are so extraneous.

The main agencies for the supply of credit may be divided into the fully organized banks of western type, the indigenous bankers, whom it is convenient to designate *shroffs*, the urban money-lenders and the rural money-lenders.

Of the first class enumeration is easy. It consists of the branches of the Imperial Bank, ten in number, operating in the province; two large banks, the Allahabad Bank and the Central Bank of India, each having one branch in the province, but controlled outside, with the Benares Bank similarly controlled but having two branches here; two considerable banks of local origin and control,

the Bank of Bihar and the Chota Nagpur Banking Association, with five branch offices each besides their head offices (all but one inside the province); and lastly five banks, each located in a single town, the Hazaribagh Bank, the Deoghar Bank, the Cuttack Bank, the Puri Bank and the Jagannath Bank. The last sub-class are mainly loan offices, which attract a certain amount of local capital and lend principally to consumers. It is unlikely that their total working capital much exceeds 15 lakhs, and thus their contribution to credit facilities is small at present. The two more important banks of local origin, the Bank of Bihar and the Chota Nagpur Banking Association, do much more commercial business, though they also engage in the supply of consumers' credit. Their potential capacity to lend, *i.e.*, their working capital, may be put at something like 70 lakhs. The four non-domiciled banks, including the Imperial Bank, perhaps between them contribute as much again to the credit needs of the province as the domiciled banks. Thus it will probably be not far wrong to put the loan business conducted by this agency as a whole at something like 1 crore in the slack season rising to 2 crores in the busy season.

Akin to the joint stock banks in that they are fully organized, but differing widely in the functions which they aim at performing, are the co-operative banks of the province. These consist of the Provincial Co-operative Bank and some 66 central banks, the former operating mainly as a source for supplying working capital to the Central banks, which in their turn supply their affiliated primary societies with funds for lending

to their individual members. The working capital of the primary societies, which is the figure we want for examining how large a share the co-operative movement plays in meeting credit needs, is now in the neighbourhood of 3 crores, and perhaps $2\frac{1}{2}$ crores is ordinarily out on loan.

The only other agency in the province, which fully satisfies the generally accepted definition of a bank, is the indigenous banker, to which in the Bihar and Orissa Committee's Report the title of *shroff* is restricted. For inclusion in this class it is necessary that the person or firm should, in addition to lending money, use the machinery of credit to raise money by accepting deposits or drawing and discounting bills (*hundis*) in the money market. As far as our enquiries could reveal, true *shroffs* are uncommon, probably only 150 in all throughout the province, and it is unlikely that more than 10 of these restrict themselves to purely banking business. The share, which shroffs take in supplying credit, is very difficult to estimate in the absence of published accounts. But it would seem that this class together with another 3,000 or so substantial money-lenders, who pay income-tax, have a total capital employed in loan business of about 11 crores.

The figures supplied by the income-tax authorities to our Committee, when analyzed, point to the true *shroffs* employing about 2 crores in their business, leaving some $3\frac{1}{2}$ crores for the business of the other large urban money-lenders who do not attract deposits or discount bills, and another $5\frac{1}{2}$ crores for the corresponding class of

large rural money-lenders. The class may be broadly defined as those who employ a capital of Rs. 20,000 or more in banking or money-lending business.

Thus pure bankers at most provide this province with credit to the extent of seven crores only, while money-lenders who pay income-tax on their loan transactions contribute some nine crores more. It might be argued that given a sufficiently rapid turn-over of these sums the credit needs of the province, which I have put at 50 crores a year, could be satisfied by them. But I have already allowed for the factor of time in estimating those needs, and thus the part played by organized banking or by money lending, which is within the possibility of organization is represented by the figures I have given here. In fact it is over-represented, since it is assumed that these sums are fully employed in supplying credit needs for every moment of the year. It is evident then that the great bulk of the credit required in this province, perhaps some 34 crore—years, or two-thirds of the whole, comes from other sources. It is well known that the fixed capital for the major industries is raised mainly in the London, Bombay and Calcutta money markets and that the managing agents, by the credits with the banks at the great cities, supply day to day finance. The medium industries are largely financed from the private resources of the richer *shroffs* and money-lenders, as personal investments rather than banking loans. The finance required for the cottage industries is as a rule obtained from the small rural money-lenders with whom we have yet to deal. Commercial credit is the main function of

the organized banking of the province, excluding of course co-operative banking, and absorbs most of the loanable capital of the banks and the *shroffs* operating in the province. A small portion of it is provided by the exchange banks operating at the ports, who finance the export houses dealing with products destined to cross the seas, or in like manner assist the merchants who import goods for consumption in our province. But the great bulk of the credit, which supports both the movement of commodities into and out of the province to the value of some 40 crores annually each way, as well as the trade in commodities produced and consumed within the province, is supplied by the traders themselves with the assistance of the unorganized dealers in credit, *i.e.*, the urban and rural money-lenders of all grades.

To a large extent the traders are themselves money-lenders, while many of them combine trading on their own account with the profession of *arhatia* (commission agent), who buys on the account of a larger merchant with funds supplied by him. The credit used is very generally personal credit, based not on hypothecated goods but on a knowledge of the borrower's character and solvency. Where a document is used, other than a mere entry in the account books of the lender *(khata pata)*, it is nowadays as a rule a *purza*, *i.e.* a promissory note strictly payable on demand, though with a gentleman's understanding not to present it too soon, and comparatively seldom a *muddati hundi*, payable on presentation at a specific date.

The principal agencies which supply consumers' credit in the towns and to the landlords in rural

areas, are the urban and rural money-lenders. Some of the joint stock banks do a larger share of this business that might be expected; but their resources are hardly great enough to make their contribution very material at present. The amount of this type of credit is disproportionately large in comparison with that available for productive purposes, and this is especially the case with credit for landlords. Lastly it has to be described how the credit, which the most numerous class of the population, the agriculturists, require, is supplied to them. The volume of this is, I may remind you, something about 109 crores carried over for periods ranging from more than one year to twelve years, with another 20 crores ordinarily repaid in the year. No doubt the standing debt is discharged in part each year too, but it is reincurred to approximately the same amount, though the persons who owe it will vary from year to year. This very large credit demand is clearly altogether beyond the capacity of organized banking as it exists at present in the province. Even the co-operative organization which devotes almost all its resources to this class of credit, deals with a bare 2 per cent. of the requirements of cultivators. The shroffs have still less concern with them, and the urban money-lenders large and small do not as a rule touch this class of business. It is then the large and small rural money-lenders who meet almost the whole of this credit need, and since it appears that the former have only some 5½ crores of capital employed in money lending pure and simple, it is clear that the bulk of the credit is supplied by money-lenders employing capital of less than Rs. 20,000. Indeed

the rural money-lender probably includes nearly every one, who has any considerable savings. The precept " neither a lender nor a borrower be " has few followers in the villages.

A sum of 34 crores may be put down as the annual credit advanced to the ordinary cultivators by money-lenders of all kinds who escape the net of the income-tax collector. This means that if a creditor advances Rs. 1,000 and does not expect to get it back for 10 years, his advance is taken as Rs. 100 for a year. Similarly if he advances Rs. 25 for three months, that will be counted in the total as Rs. 100 for one year. On this basis it seems likely that the number of such money-lenders is at least 100,000 and might be considerably more. The evidence we collected in the course of our enquiry indicated that the vast majority of these had no real connection with the urban agencies, still less with the money markets of the great towns. In so far as they are traders as well as money-lenders they command some supplies of urban credit. But it is obvious that they cannot lend to the cultivator even for 3 or 4 years on credit raised for trade purposes without courting early disaster. There is no evidence that the *shroffs* or substantial money-lenders place out much of their funds in medium or long term loans with the small rural money-lenders, save possibly in the immediate vicinity of the towns. I am convinced then that the bulk of the credit given to agriculturists is supplied by the small rural money-lenders from their own savings.

This completes a rough sketch of the agencies for supplying credit at work in the province. In the supply of trading, industrial and consumers'

credit organized banking, including the *shroffs*, occupy a moderate part of the ground; and the other agencies, substantial money-lenders, managing agents, commission agents and so on have some direct or indirect access to banking facilities. But the largest and from the civic point of view, the most important demand for credit, that of the cultivators, is met by agencies, which, save for the small incursion of the co-operative societies, are almost completely divorced from banking.

Thus the supply of credit, save for trade purposes, is almost certainly much below the effective demand, and that credit is very largely supplied by agencies outside organized banking. I think that two necessary results flow from these facts, both of which are readily detected in our province. The first is that rates of interest are generally high and the second is that they do not vary with the fluctuations of the pressure of demand on supply. In fact interest rates tend, like many other things in India, to be customary and not economic.

Even in trade interest rates are generally stable within narrow limits. The ordinary rate is 7 to 9 per cent. per annum whether the credit is supplied by wholesale dealers to retailers, by *goladars* to traders awaiting their market, or by banks to *goladars* holding their own stocks. There is no indication that these rates are diminished when funds seeking profitable investment are plentiful, or increased when money is tight, except that the Imperial Bank, when lending on stocks, fixes a lower limit of 1 per cent. above "bank rate." Otherwise the rate at which interest is charged

depends on the financial stability of the borrower, and on nothing else.

The rates charged for credit to the cultivator vary between far wider limits, and reflect to some extent the magnitude of the supply of *local* capital, though not, I maintain, the supply of *general* capital, available.

It is significant for example that in the Orissa districts, which as a rule grow more rice than the population consumes, the rate for grain loans for a period of anything from two to eight months is 25 per cent., while in the Chota Nagpur and Bihar districts, where rice has usually to be imported it is 50 per cent. Again it is undoubtedly a fact that in the Bihar districts there is a much greater accummulation of capital than in Orissa, while Chota Nagpur lags even further behind. Reflecting this we find a prevalent rate for cash loans in Bihar of $18\frac{3}{4}$ per cent., in Orissa of 25 per cent., and in Chota Nagpur of $37\frac{1}{2}$ per cent. per annum. It may be interesting to note that these figures have been obtained by examining the answers given by investigators, who carried out surveys in 123 villages and in 19 out of the 21 districts of the province. They were asked to state the rate of interest current, and as a rule stated a number of such rates. The frequency with which each rate was mentioned was tabulated, and the most frequent, which was also on the whole a close approximation to the average, was taken as the prevalent rate. It is a strong confirmation of these figures and of their probable connection with the local supply of capital, that the co-operative societies lend in Bihar at about $14\frac{1}{16}$ per cent., in Orissa at $15\frac{5}{8}$ per cent., and in Chota Nagpur at either that rate or $18\frac{3}{4}$.

Inside the tracts the rate, of course, varies with the creditworthiness of the borrower, with the size of the loan, and to some extent with the extent to which it has been swelled by accummulation of interest. For example when the loan has run through its ordinary course of first being represented by a mere entry in the money-lender's books, then backed by a handnote and finally by a mortgage on the holding, the interest is usually reduced. If the mortgage is a usufructuary one, the interest, *i.e.*, the return from the land of which possession is taken, is seldom more than nine per cent. on the accummulated debt and sometimes only six per cent.

These are the rates at which the ordinary money-lender lends to the ordinary cultivator. The landlords, mainly perhaps because their transactions are larger, borrow at 12½ per cent. in Bihar, 20 per cent. in Orissa and 18 per cent. in Chota Nagpur. It is also necessary to add that this survey leaves out of account the dealings of the itinerant money-lenders, Kabulis and others. Their rates are very much higher ranging from 50 to 125 per cent. per annum. But their business is relatively small and the bulk of the cultivators have few transactions with them. The picture that is sometimes drawn of the mass of the rural population paying interest at 75 per cent. or more is, I am convinced, quite untrue for this province. The position is bad enough as it is, but it is not as bad as that. How bad it is may be seen at once by applying the rates given above to the debt of ordinary cultivators in the three tracts that make up the province. The result is that this class of some 4¼ million households is required to find

about 26½ crores annually as interest on their debts. The value of the whole agricultural produce probably varies between 150 and 90 crores according to season and price, and though there are other resources besides crops to swell the total rural income it is obvious that the interest charge is a very grave burden. It is scarcely doubtful that it is not really paid in full, nor the balance left unpaid really carried over to swell the total indebtedness.

The interest charged by ordinary rural money-lenders in Bihar and Orissa is by no means abnormal for India as a whole. Indeed most of the other Provincial Committees quote rates at least as high or higher, with the exception of Madras, where the ordinary transactions on promissory notes appear to bear interest of 15 to 18 per cent.

Now, taking a general average of 20 per cent. as the rate of interest customary in the province as a whole, and it is certainly above rather than below that mark, a debt at compound interest, if no interest is paid, trebles itself after six years. No system of credit and no industry that is subjected to it can possibly stand the rigorous enforcement of such terms, and one is driven to the conclusion that they are not really enforced and that in fact much of the indebtedness in rural areas is on paper only. Still the possibility of enforcement (and in spite of the Usurious Loans Act the Courts when the cases are pressed before them have little option in the matter) is a grave menace for the debtor, and a system of credit that depends for its success on the good nature

of the creditor is self-condemned. The present system of rural credit in effect gives the lender the power, if he has the will, to extract from the borrower all his profits except a bare livelihood, while it encourages the latter to practice every possible trick to evade his bargain. There is little to choose between the disastrous results that follow on its occasional reality or on its general unreality. It is closely paralleled in South Bihar by the produce system of rent.

Apart from these ill effects which arise from the present rural credit system in its reaction on lenders and borrowers, there is the additional defect that it is outside the organized finance of the country and so lacks the support, which can be given in time of need by that organization. In hard times precisely when the cultivator wants an expansion of credit, the village mahajan is inclined to contract it. In extreme cases, when severe scarcity is apprehended or actually in sight, Government steps in to supply extra credit in the shape of Agriculturists Loans. But the relief so afforded is not available for a less severe crisis, and it would be far better if the flow of credit from the general reserve of the savings of all classes could be made more automatic. Further the cultivator gets little or no benefit from any fall in the general interest-earning capacity of capital, that may occur seasonally or in longer periods.

The problems then are *first* to reduce the rate of interest, *second* to remove the dead weight of the existing debt and *third* to link rural credit in with the general credit system. The solution of these problems will occupy the best brains and

the keenest energies of the province for years to come. But a failure to solve them will be absolutely disastrous.

The Provincial Committee considered very carefully the possibility of working in to the banking system the rural money-lender, as he now is. He no doubt has his merits as well as his defects. He is not as a rule, I firmly believe, the rapacious and stonyhearted bloodsucker that he is sometimes depicted. He meets the demand for credit quickly and with little formality, and exercises a degree of patience and at times complete forbearance in the recovery of his dues, which is agreeable, even if demoralizing, to his clients. But it seems to be altogether outside the range of practical politics to regulate his operations and to treat him as a part of organized credit. The money-lenders are too numerous and their status and methods of dealing too various for that to be a general solution.

At the same time, in a limited field, it seems probable that something might de done in this direction. With one dissentient, Mr. Hodge, our Committee recommended that an attempt should be made to organize the rural mahajans, broadly those who already pay income-tax on their money lending business. The idea is that these, or some of them at least, would be prepared to accept a certain degree of control in return for facilities for quicker realization of their dues, more adequate finance and some remittance privileges. Those, who did so accept, would be brought on a register, and would then be under obligation to

abide by the conditions of registration. A registered mahajan would be required to keep his accounts in a standard form, not necessarily in English, and to allow them to be inspected by a Government auditor once or twice a year. The report of such audit would be a confidential document for the information of the registering authority only, and would not be divulged even to the income-tax authorities. He would be required to limit his rate of interest, perhaps to 3 per cent. above "bank rate," which is the rate at which the Imperial Bank is at the moment lending to first class parties. He would be urged to advance, as far as possible, against *muddati hundis* representing the value of growing crops or of stocks held by the borrower perhaps in licensed warehouses if those come into existence, rather than against personal credit on a mere book entry. It is not contemplated that he should be empowered to accept deposits from the general public, but he would not be debarred from engaging in trade or other business in his own account. In return for an obligation to abide by these conditions the registered mahajan would receive the right to realise by means of the certificate procedure, under the Public Demands Recovery Act, debts accruing on account of failure to meet *muddati hundis* on their due dates. Such an arrangement will be necessary in order that these instruments of credit should be readily discounted by the urban banks, who may be presumed to know something about the registered mahajan but will know nothing of the second signature on the paper, that of his client. If, however, they know

that the registered mahajan can be reasonably sure of forcing his client to satisfy his demand within six months at most, the credit of the mahajan, who has accepted the paper, should be sufficient for safe business. Further, if the agriculturists can get their credit at something about 9 per cent. instead of anything from 12 to 25 by engaging to meet their liability in, say, three months, the honest and prudent men among them will no longer have to pay for the sins of the others. It is to the creation of such paper that we may look for the improvement of financial facilities to be granted to the mahajans who come into the scheme. As long as their business is within the limits of their own capital they will merely hold the *hundis* until maturity. If, however, more business presents itself they can discount them with urban banks and employ the funds so obtained to take up more.

To stimulate a readiness to come into the scheme, it may also be possible to arrange that registered mahajans should have the same privileges for remittance through the post office as the co-operative banks now enjoy, viz., that three-fourths of the charges made for money orders are refunded on presentation of the account at stated intervals. It might also be arranged that they should be empowered to open current accounts with the post office from which they could withdraw by cheques as well as receive by cheques from their customers.

Against this scheme it may be useful to set the objections, which the United Provinces Committee have endorsed.

" Firstly it would be difficult to induce either the Reserve Bank or any district co-operative bank to give a money-lender easy credit; the Reserve Bank could scarcely be expected to deal with such small fry, and a district co-operative bank could scarcely be expected to finance one of its own rivals. Secondly, it would be quite impossible to ensure that a money-lender observed the conditions of his license; and if he did not, the only possible penalty would be to revoke the license itself, which, since he would then resume independent operations, would scarcely act as a deterrent. Thirdly, no money-lender would be willing to take out such a license if it involved the auditing of his accounts. Finally such a scheme would merely restrict credit without controlling it."

To the first objection I would reply that there is no idea of confining the relations of mahajans with organized banking either to the future Reserve Bank or to co-operative banks. Whatever type of Reserve Bank is evolved there will probably be not more than at most three branches of it established in this province and their function will be to act as bankers for the joint stock banks and other banking institutions operating in the area. It is not with the Reserve Bank but with its customer-banks that it is hoped that this discounting business will be established. Nor is it expected that much business will be done with co-operative central banks, who should be employing their money on loans to a class, which will not ordinarily overlap with those who may become the clients of the registered mahajans.

On the second point it is evident that it is impossible to say *a priori* whether the mahajans will value the privileges that the scheme may give them sufficiently to be restrained from breaking the conditions. If many of them apply for registration it may be safely presumed that they will. The third objection is again one that has to be tested by experience. The mahajans, whose case we are contemplating, are obliged to submit to examination of their accounts by the income-tax authorities, on pain of summary assessment; it is not clear why an emphatic negative should be given off-hand to the question whether they will accept a confidential audit by a somewhat more sympathetic agency in return for privileges.

The last objection is difficult to interpret. It is hard to see why a scheme which aims at putting more finance in the hands of rural mahajans restricts credit though it may also aim at cheapening it for those borrowers, who are prepared to accept the conditions. Nor is it obvious that the control proposed would be ineffectual. After all the co-operative system has conditions under which it has to be worked, and aims at cheapening credit without controlling it.

Mr. Hodge's objections seem to me to have more weight, but I think they may be answered. They are (1) that credit needs in rural areas can be fully met by development of co-operation and extension of indigenous banking; (2) that the scheme proposed will meet with the difficulty of selecting the mahajans, the difficulty of supervising them, and the difficulty of framing conditions which they will accept and which are also

in the interest of the public. I think it will be made clear in my next lecture that co-operation is extremely unlikely to meet the full rural credit needs in any period less than 30 years and then only if the State can find the money for its sound development. It seems to me equally clear that the indigenous banker or *shroff* shows no signs at present of extending his business into the rural areas. He is far more likely to do so if the best of the existing rural credit agency is organized. So far from seeking to put the shroff's business out of court, it is really part of our scheme to induce him to help in supplying finance to rural areas by discounting agricultural *hundis* with the backing of registered mahajans.

I can see no serious difficulty about selection. The mahajans will select themselves by applying for registration, those who fail thereafter to abide by the conditions, will be removed from the register. Supervision is more of a difficulty and involves the creation of an adequate controlling authority. An authority is required for the supervision of co-operative banking but its control is admittedly weakened by the need of working through central bank directorates, and the undesirability of liquidating such institutions, in which the outside public has invested money and to which a large number of poor cultivators look for a continuance of credit. The difficulties which the authority controlling registered mahajans would have to meet seem likely to be much less than those with which the Registrar of Co-operative Societies and his staff are confronted.

Framing of conditions is no doubt always a difficult job, but I cannot see that those which the scheme proposes would be necessarily unacceptable to the mahajans or detrimental to the public interest.

The scheme discussed above aims at providing better short term credit for a class, who have the power and the will to repay promptly. There is also the problem of clearing the old debts of the class of equal or higher economic and social status, who have allowed themselves to drift into serious embarrassment. The problem is one of long term credit and requires separate treatment. It seems to be established that some 20,000 to 25,000 households of land-holders throughout the province owe mainly to unorganized credit suppliers not less than 12 crores of rupees. It appeared to us desirable to consider, both in the interest of the debtors and in order to bring such a substantial amount of outstanding credit within banking organization, whether a special land mortgage bank should be established to solve this special credit problem. We decided to recommend such a scheme and have drawn up one in considerable detail, which it is unnecessary to set out here. The scheme no doubt will only benefit a comparatively small class, who should be in a position to look after themselves. But it is a class whose present embarrassment is the cause of much of the stagnation in rural areas, if not of actual harassment to the tenantry of the debtors. The supply of credit at reasonable rates of interests and for reasonable purposes only might do much

to check both embarrassment and extravagance in this class. But the scheme depends mainly on the support it gets from the more enlightened and solvent members of the class, who should be called in to assist in its management and may be expected to take up a considerable part of the debenture capital that it will be necessary to raise. If anything is to be done to improve the position of this class, it seems desirable to do it by some such scheme as this, rather than to extend to other parts of the province, as has sometimes been suggested, the provisions of the Chota Nagpur Encumbered Estates Act. It has to be admitted that, while such a scheme will probably for the time being benefit the substantial rural money-lender by securing the repayment of some of his doubtful debts, it will, if successful, ultimately cut out a large slice of his present business.

I have yet to mention one other scheme, which found favour with our Committee, which is intended to bring existing credit agencies more closely into relation with organized banking. It is dependent on the creation of a Reserve Bank, to operate as a bankers' bank. If that comes to pass the question will naturally arise what institutions will be permitted to associate themselves with it as member banks. Obviously the joint stock banks will have that option, if they are prepared to accept the conditions of subscription to the capital of, and deposit of a proportion of their liquid assets into, the Reserve Bank. No doubt too the Provincial Cooperative Bank will be eligible. What our Committee has proposed is that it should also be open

to *shroffs* to apply for membership, and that their application should be accepted provided they accept a confidential audit in place of publication of their accounts for which they are not at present prepared. It has also been recommended that it should not be necessary to insist on *shroffs*, who desire to become members of the Reserve Bank, giving up business other than pure banking. The danger that might arise could be met by securing through audit that the accounts of the banking business were kept clear of other business and that banking assets were not employed in such business. The establishment of a class of "approved *shroffs*" who could revive their diminishing power to attract deposits, which their holders are unwilling to entrust to the joint stock banks with their greater rigidity of system, and who can take up banking business, which western banks have not enough personal knowledge to touch, would greatly expand the sphere in which the organized banking system can operate, and make the control of credit in difficult times much more effective.

LECTURE IV.

The Future of Co-operative Banking.

In the latter part of my last lecture I was placing before you the schemes, which the Provincial Banking Committee have put forward, for bringing into closer contact with organized banking the credit agencies which at present stand outside it, and generally for improving credit facilities especially in the rural areas. Though I think those schemes deserve very careful examination by those who have to decide whether they should be put in force, it is obvious that they will do comparatively little to solve the greatest credit problem of the province, the indebtedness of the ordinary cultivators, who make up some two-thirds of the total population. For that the sole solution is, no doubt, as practically all competent observers are agreed, a wide extension of the organization of co-operative credit.

I do not propose to-day to attempt a general survey of the co-operative movement as it stands at the moment in Bihar and Orissa much less to analyze in detail its development and tendencies. I refer any one who wants that kind of information to our Report and to the annual departmental reports. What I hope to do is to detail and defend the principal recommendations set out in our Report.

The first and to my mind the most important recommendation is that short term and long term business in the central banks should be rigidly separated. I think there is unimpeachable evidence that the central banks have been steadily increasing their long term business and that it now locks up

nearly half of their working capital. Most of it has been for the purpose of repayment of debt or what is nearly the same thing redemption of mortgaged land, some for the purchase of land and a little for improvement of land already held. Now it must be obvious that a loan made for any of these purposes cannot be repaid by the borrower on the profits which he expects to derive from the loan in a few years. It is unlikely that the difference between the interest he paid to the mahajan and that which he has to pay to the central bank is more than 10 per cent., and it will thus be at least 10 years before the accumulated saving reaches the capital sum lent. It is equally unlikely in present conditions when pressure to invest savings in land has pushed up the prices paid for it, that the price will be recouped in less than 10 years. Lastly there are unfortunately few improvements which are likely to pay for their initial cost in less than that period.

And yet we find that the central banks never lend for a period exceeding seven years and most of them stop at five. The result is constant defaults and the very unsatisfactory practice of revising the *kists*, or due dates for paying instalments. When *kists* are revised they are treated wholesale, and the true long term borrower probably gets less relief than he requires, while the short term borrower gets more than he deserves. In any case every time that *kists* are revised it makes it more difficult for the banks to insist in the future on punctual payment.

Another and perhaps an even more dangerous feature of the present confusion of all types of loans in one account is that it is extremely difficult

for the directorate to see at any time, whether long term business has a sufficient backing. Apart from debentures, by which means the co-operative movement has not yet attempted to raise money, it is only the paid-up share capital and the reserves that can unquestionably be used to support what are in fact land mortgage loans. The central banks in the period 1923 to 1928 lent out some 162 lakhs of rupees for purposes, which are certainly to be classed as long-term. It is unlikely that any substantial proportion of this sum has been repaid. The existing resources of the central banks by way of paid up capital and reserve are about 35 lakhs only Thus it is clear that much of the land mortgage loan business is supported by deposits of which the bulk is held at call or one year's notice, or by the finance supplied by the Provincial Bank. The situation seems to me now much more menacing than our Report makes out, and to require a very thorough examination by the auditor staff. The co-operative organization is the only possible one to take up the functions of a land mortgage bank for the smaller agriculturists. It is thus all the more imperative that the soundness of the lines on which it is performing those functions should be beyond cavil.

The next point that I wish to urge is that a very earnest endeavour should be made to secure much more rapid disposal of loan applications. It is very disquieting to find that in some areas there is such grave delay. I quote from our Report—

"Though some banks can put through the business in one week, a month or even six weeks frequently elapses between the application and the actual receipt of the money by the individual

member. The reason for this delay is that the central banks, as a rule, insist on a scrutiny of each and every loan application by their own staff, if not by the working committee of the directors. We cannot believe that so much caution is really required, and we agree with those witnesses who urge that the practice stunts the growth of responsibility in the primary societies themselves. The remedy is the cash credit system, by which the primary society is allowed to draw on the central bank up to a maximum, fixed at the beginning of the year, for needs which have to be met promptly. This is already working satisfactorily in some central banks who have granted the facility to their better primary societies and we recommend that it should be extended as rapidly as circumstances permit. It is true that in some primary societies the difficulty is met by obtaining temporary deposits from the richer members, but speaking generally it is clear that, at present, the members of primary societies are often obliged to resort to the money-lender for short term loans. Though these may be repaid as soon as the central bank's money is received, the interest on them is not negligible, and the position of the members is unnecessarily worsened."

Next there has been in the last few years a growing tendency to insist on collateral security for all loans over a certain sum, often Rs. 100, in the shape of a mortgage on the whole or part of the borrower's holding. It is estimated that about 50 per cent. of the loans outstanding are now so secured. No doubt it may be desirable to take such collateral security for considerable long term loans, but the unlimited liability of all members

of a primary society should be sufficient for other loans. An argument advanced for the practice is that it prevents the co-operator from going to the mahajan. I doubt it. He probably goes to the mahajan and gets worse terms. In the Punjab mortgages are rarely taken and the need for taking them is put forward as an objection to a scheme for taking over debts to mahajans on a composition. In the recent investigation into the crash of co-operation in Burma the following recommendation is to be found :

"We, therefore, recommend that the village society should confine itself to personal sureties for all loans and should protect itself by limiting the loans to amounts and for periods for which this security is suitable."

It seems very necessary that the desirability of this practice which appears to have been introduced without very full consideration should be re-examined. It looks very like a convenient short cut to granting loans freely without taking the trouble to investigate the need for them in a truly co-operative spirit.

Another point which I wish to make to-night is that the whole structure of co-operation may easily be endangered by excessive development of side shows. I regard the function of the co-operative movement as first, second, and third to improve the credit facilities of the ordinary cultivator, and deprecate as strongly as I possibly can putting money on the "also rans." We have had our experience in this province of some of these unhappy selections. The weavers in Ranchi were to be helped by marketing their products. There is

I believe a fine stock of these still on show, and a debit balance of some Rs. 40,000, of which the organizers recently tried to pass on a lump to the long-suffering taxpayer. There was a bright scheme for running a co-operative store in the Puri district. I forget how much that has cost the Central Bank, but it was enough to give its depositors a severe fright. There were two societies for selling grain, both disastrous failures. In this connection I wish to read a passage from our Report : —

" Of co-operative sale there are many advocates. Indeed it is a standard doctrine of the keen co-operator that the salvation of the cultivator lies, to a large extent, in bringing in his produce to the warehouse of his sale society, from which he would draw money for his immediate needs, pending the sale of the produce at far more remunerative rates than he gets at present. The idea has recently gained a benediction from the Royal Agricultural Commission. The success of such sale societies depends, firstly, on there being a margin between the lowest and highest price during the period for which the product can be stored, sufficient to cover warehousing, interest and management charges and still leave an attractive profit. Secondly, it depends on securing managers, who have the ability to judge accurately the course of prices and the character to resist and prevent peculation. Thirdly, the producers themselves must have a sense of loyalty to their sale society, strong enough to keep them from snatching chance opportunities of larger profits by selling elsewhere or from deserting the society on the first appearance of loss. If these three condi-

tions were fulfilled, co-operative sale societies might succeed in intercepting some of the profits of marketing which now go to the middlemen and in returning them to their producer-members. But it has already been shown that the margin between the lowest and highest price of the main staple, paddy, is much smaller than is popularly supposed, and the handling of it at different stages of marketing does not yield any large profit. Nor can the course of prices be forecasted even here with certainty. Still less can it be forecasted for other products, such as oilseeds, tobacco, *gur* or potatoes, which have wider markets, and whose price is settled by more various factors. Secondly, it is very unlikely that managers of business ability and sterling honesty could be secured, save at salaries which would swell markedly the overhead charges. Thirdly, it is unfortunately the experience in this province that the formation of a co-operative credit society does not immediately create a real co-operative spirit, and the chance of a collapse owing to the withdrawal of the support of the producers in the face of difficulties or disappointments is not negligible. There have, in fact, been only two experiments in co-operative marketing of any importance in recent years, and both of these have been disastrous failures, brought about by a combination of the factors which have been indicated. We do not agree with the view that sale societies would be successful if organized on a much larger scale, and fear that any attempt to put it into practice would merely involve larger losses than those already suffered. In these circumstances, the Committee are bound to re-

commend that further experiments in them should not be taken in hand, unless and until there is a clear demand for them by producers themselves, after the dangers of sinking money in an attempt to compete with a well-organized system of marketing have been fully set forth before them."

This was written before the collapse of the jute sale societies in Bengal whose success was urged before us as an argument against the view expressed above. At about the time that we were expressing our view, the Bengal Committee was stating its opinion that these jute sale societies had "great potentialities." They had for they nearly brought Bengal co-operation into general liquidation.

I should also like to press the view that co-operation can do nothing useful for the encumbered landlord. By all means attract the money and better still the active assistance of the solvent landlord, who represents the strongest element in credit and brains in the rural areas. But do not attempt to put into credit societies otherwise composed of small men, the indolent and improvident landlords, who disgrace their class. If you do you will find that like the young cuckoo in the hedge-sparrow's nest he will eat all that should be shared among the nestlings.

It is generally claimed by co-operators that not only do they lend to members at a lower rate of interest than the prevailing rate, but that their invasion of the field of rural credit has brought about a general fall in interest rates. While the first claim is well founded the second is more doubtful. But still the interest rates in this province, even of the co-operative societies, are far above what the

agricultural industry can bear. No real progress can be made in the next problem, the reduction of indebtedness, until rates come down. But I will reserve what I have to say on the reduction of interest rates and deal with that of indebtedness first. While the co-operators have made some impression in this province on the problem of supplying short and medium term credit to the cultivators, they have not, in spite of the lock-up of a large proportion of their capital in the attempt to do so, really begun seriously to reduce indebtedness. Indeed such statistics as are available tend to show that indebtedness even of members is increasing, though the explanation that full disclosure of debt is only obtained after some years of membership is put forward with some confidence. In any case it appears that of the debt borne by the members, only about two-thirds is owed to their societies, and the rest still to their mahajans and banias. Further only about five per cent. of potential members, i.e., those cultivators who are now in debt, are actual members.

It is as well to make an estimate of the magnitude of the problem. Let us assume that each year fresh members are brought in at such a rate that for every 100 old members nine recruits are found (and that is about the present rate of expansion) and further that it is intended to clear off all outside debts of existing members in seven years from admission. It may be calculated that in eight years there will be about double the number of members, and that some 4 crores of outside debt will have been taken over. It would take 32 years to absorb 80 per cent. of the potential members, and by that time 60 crores of debt might have been taken over.

These figures illustrate the magnitude of the problem, but do not, I fear, mean that it will be solved by a natural and automatic expansion of co-operative organization. Even in the Punjab, where co-operation has gained a much firmer hold than it has here, the difficulty of providing for repayment of existing debt is recognized to be immense. To quote from the report of that Province—

"At present, like large boulders on a hill road, old debt and high rates of interest block the path of advance that many, who have learnt something of the use and abuse of credit, would gladly tread, and the high rates of interest are yearly adding to the debt."

Though 31 per cent. of the loans given by the Punjab ordinary primary societies in the last five years have been given for repayment of debt and redemption of mortgaged land, still 57 out of every hundred members of societies that have been working for 10 years are still in debt. A suggestion is made in the Punjab Report that money-lenders, who are, it is said, finding it increasingly difficult to recover their loans might be induced to compound the debts of members of societies, taking in exchange credit for a deposit of the amount agreed upon, which will be paid off by instalments spread perhaps over ten years. This is a suggestion, which might well be examined in our own province, where the indebtedness has also grown in many cases, and where if the deductions from the available statistics that I suggested in my second lecture are correct, general growth of indebtedness is in the present conditions inevitable. These deductions were (1) that only two-thirds of

the loans taken, for short term purposes, for maintenance, cultivation expenses, repairs to houses and payment of rent are repaid on the harvest of the year, and (2) that debts covered by registered mortgages take on the average 12 years to liquidate.

The Punjab co-operators have, however, gone further than, I believe, those of any other province in organizing land mortgage banks, whose sole object is to produce funds for repayment of old debt, land redemption, land improvement and very occasionally land purchase. These are still in the experimental stage and have advanced only 32 lakhs so far. It is a disquieting feature that one in every three borrowers from these banks is behindhand with his kists.

It is very doubtful whether in our province a separate organization for long term credit intended principally to repay old debt is desirable. It is not easy in most places to get together a good directorate for one co-operative bank, and it would seem to be better to allow central banks to combine this banking function with the supply of short and medium term credit. But as I have said it is absolutely essential that the accounts and generally the business of long term credit should be separated from that of shorter term, and that provision should be made for financing long term loans from other sources than deposits of short currency. Already the central banks are doing as much of long term business as the amount of their long term capital justifies, and any considerable expansion of that business without strengthening the appropriate backing for it will jeopardise the finance of the whole movement.

On the possibility of reducing the cost of credit to members, I wish to point out that while central banks now borrow from the public in the shape of deposits at rates of 6 or occasionally 7 per cent.; they lend to the primary societies at 11½ to 12½ per cent., and the primary societies lend to the members at 14 to 16¾ per cent. The annual reports show that the cost of management of a central bank is about 2¼ per cent. on its working capital, with a distinct tendency to rise, while the cost of management of a primary society is about ⅔ per cent. These figures show that there is a gap in all of some 5 to 5½ per cent. between the rate of borrowing by the central bank and the rate of borrowing by the individual member which is not covered by cost of managment. It seems to me it must be put down mainly as the cost of mismanagement.

No doubt it is impossible to employ all the funds of a bank profitably for every minute of the year, but then a good part of the funds used in the co-operative movement is owned capital, not carrying heavy rates of interest if any at all. So it seems to be imperative that the reasons for this large gap should be thoroughly investigated, and it is reasonable to suppose that by such an investigation a reduction to the prevalent rates in Madras and Bombay, where the cultivator-member gets his credit at 10 per cent., could be accomplished.

Thus co-operation by constant and watchful effort should be able in time to solve the problems of reducing the rate of interest and the burden of old debt. It is little use trying to do the latter without the former. It also gives hope

of solving the problem of linking the credit needs of the rural population with the organized banking system in this province. Its apex bank, the Provincial Co-operative Bank, has established a reputation for sound management, and there is no apparent reason why it should not get into close touch with the money market. It will certainly have to do so, if it is intended to raise the capital needed for a considerable effort to reduce old debts. There is also scope for an attempt to attract temporarily into the co-operative finance some of the funds that are apt to lie idle between the time that the movement of the main harvests is completed and the time that the movement again becomes active. The co-operative societies must now be doing a good deal of the short term business, which is the standby of the rural money-lender, *i.e.*, advances for seed and maintenance repayable on the harvest. It seems as wasteful to finance these from one year deposits, as it is dangerous to finance debt redemption from the same source. No doubt there would be some overlap between the date on which these advances are repaid and the date on which the commercial banks, the indigenous bankers and the merchants want funds for their main business of moving the harvests. But it would be good business to get fully utilized money at, say, 3 per cent. for four months and 7 per cent. for two months, instead of money for a whole year at 6 per cent., which is only used for six months.

Before closing my remarks about the part which co-operation should play in this province, I should like to re-emphasize a few points. Firstly,

it can play no satisfactory part whatever, unless it really educates the borrowers in the use of credit, and in the habit of punctual payment. So far it has been anything but generally successful in this object. Secondly, it must vie with the rural money lenders in speedy satisfaction of real credit needs. Thirdly (and on this point I am probably running counter to a large body of opinion among keen co-operators), it must concentrate its energies and resources. I hold strongly that the rural credit problem is far the most urgent one, and am against dissipation of effort on less urgent matters.

I would also press that the financing of the landlord, in the sense that that term is used in this province, is outside the scope of co-operative activity. Lastly, I would again press the view that rural credit even as supplied by co-operation is much too expensive and that every possible effort should be made to reduce its cost to the raiyat for whose benefit the whole structure has been built up.

I feel that I may have given the impression that I do not fully appreciate the admirable work that co-operation has already done or the devoted labours of voluntary workers in that sphere. That is far from my intention. If I did not believe (and I admit I am a somewhat reluctant convert) that co-operation is the only solution of our principal credit problem, I should not trouble myself to point out what I consider defects. I also very fully realise that co-operation does not end with giving the cultivator the credit he requires on more easy terms than he gets it at present. It has possibilities of educating him to

a much fuller sense of his opportunities as a citizen, and of widening and deepening his outlook on life generally. That side of co-operation is not a subject for a lecture on banking, and it has had many much more adequate and eloquent exponents than myself. But I do wish to say that though this side of co-operation is no doubt much more valuable than the purely economic side, it is quite impossible to develop it, unless the economy of the movement is in every respect sound. To secure that it is so needs the greatest possible exercise of hard-thinking, patience, vigilance, unselfishness and probity and last of all sympathy, by those whose better brains and training qualify them to lead the movement.

LECTURE V.

Commercial, Industrial and Consumers' Credit and the Stimulation of Investment.

I dealt in my last lecture with the outstanding problem in this province, the provision of better credit for the rural population. To-night I shall deal with a few points that arise in other forms of credit and in the field of stimulating investment.

I have not a great deal to say about commercial credit which is provided both by the western system and by the indigenous system of finance fairly adequately and economically. But there are some parts of the machinery that would be better for oiling. In particular that valuable and time-honoured credit document, the *muddati hundi,* is in danger of falling into disuse by reason of the omission to reduce stamp duty on it, when other instruments of credit obtained relief.

I take the following explanation of what a *hundi* is from the Bombay Report:—

"It is in essence a bill of exchange by which the drawer directs a certain person to pay a certain sum of money to a certain person or to the bearer, either on demand or on a determinable future date."

The *darshani hundi* payable at sight or on demand, is for practical purposes identical with a cheque, except that the ultimate payee is not necessarily a bank. This is the ordinary instrument used for remittance by the indigenous market. The *muddati hundi* is a deferred or usance bill of exchange, although it frequently

differs very materially in form from that document. In essence it differs only when conditions are inserted, for example, when payment is only to be made on receipt of goods covered by attached railway receipts. It is negotiated, if drawn by and accepted by respectable firms, with great ease, and when it rests, as it usually does, on a genuine commercial transaction it is a most valuable means of creating credit during the period of its currency. Its value in that respect is specially recognised in the Paper Currency Act, as it is one of the documents which when held by the Imperial Bank can be used as a backing for emergency currency to meet the demands of trade during the busy season. Since the stamp duty is relatively high and based on value, its use has recently diminished, and in its place promissory notes with a tacit understanding that they will not be presented for payment till a definite period has expired are being used. Not only do these expose the debtor to a grave risk, but they are less satisfactory evidence of the transactions for the creditor, and are practically unnegotiable.

Apart from the disadvantage, under which the *muddati hundi* at present suffers, of carrying a somewhat heavy tax, its general use is restricted by some degree of uncertainty as to the liabilities created by it in certain events. These liabilities are defined not by positive law, but by usage, and it is not always quite clear what usage is applicable to *hundis* of different kinds in different localities. The general view of the Provincial Committees is that the time has now come for defining by statute the liabilities created by

hundis of the kinds most generally in use, and for standardising the forms throughout India, in the manner in which western instruments of credit have been treated by the Negotiable Instruments Act.

There is without doubt a lack of a sufficient volume of trade bills backed by documents, or even of what are known as "clean" bills. The use of such bills is as follows. The seller of goods, for example, a wholesale cloth merchant, books an order from his buyer. On the strength of that he draws a bill payable on the expiry of a definite time, *e.g.*, three months, by the retail buyer or, if he fails, by himself. The buyer "accepts" the bill, *i.e.*, accepts the liability to meet it when it falls due. During the period of its currency the bill is negotiable. In the first place the seller can get it discounted by his own bank and use the funds so obtained for further productive business. The bank can, if it so desires, rediscount it with another bank. It is a highly fluid asset, which is automatically realised in currency on the expiry of its period, save in the unlikely event of both buyer and seller failing. If it is backed by a document, which gives command over the goods that are the subject of the transaction, for example, a railway receipt, it is certainly a safer form of investment for the banks. But its period is then in effect limited to the time of transit, since the buyer will want to take delivery of goods to avoid demurrage. Another form of document which has been sugested as a useful backing for trade bills, is the receipt of a licensed warehouse. Such documents are already so used to a limited extent, emanating

from the Port Commissioners' warehouses in Calcutta. It has been suggested that there is room for the establishment of warehouses in the larger up-country towns, which, under proper regulation, could issue receipts for goods kept pending sale or despatch, that would be acceptable to the banks as backing of trade bills. This system would obviate the somewhat clumsy device of placing under the bank's seal goods hypothecated as security for loans to traders, a practice which traders feel is a reflection on the soundness of their credit.

Credit for industries is in a far more backward state and there is much greater divergence of opinion as to the right line of development. It must always be remembered that loans to industries, whether in the form of subscription to capital, purchase of debentures or bank credit are seldom really covered by the saleable assets of the industrial concern, but are made on the expectation that the concern in question will earn a profit. Industrial machinery is so specialized and so soon becomes obsolete that it is difficult to resell it, while it frequently has to be put up at places so difficult of access, that its withdrawal therefrom eats up much of its market value. The coalfields are at present littered with unsaleable boilers and other machinery for which no purchaser could be found, when the slump in coal prices came. If then industrial credit is backed only by the probability of the borrowing concern making a profit, it is essential for a prudent lender to be able to estimate that probability. When lending on security of commodities or land or even on the probity of a merchant or a consumer,

the creditor has some evidence to go on, the course of prices of the commodity, the general local land values, the repute or style of living of the individual. But, as many of us have found to our cost, it is a much more difficult job to foresee the future prospects of an industrial enterprise, which will depend on the continuance of the demand for the product turned out and the ability of the management to produce cheaper than their competitors. The power of making such judgments with a fair balance of successes over failures is uncommon, and it is human nature to exploit such a gift for personal profit. It is, therefore, hardly to be expected that the ordinary run of bank managers will be in a position to make sound investments in industries, and, if a bank makes a practice of so investing the deposits it draws from the public, the risk to itself, its customers, and to the banking system as a whole, is considerable.

It is generally believed, however, that this cautious attitude is a prejudice confined to British banking, and that on the continent of Europe the great banks supply all kinds of finance to industry out of deposits. This is, it appears, a misconception of the practice of continental banks. New industries are started with the backing of directors of banks *in their private capacity*, pooling their private resources in syndicates. They may make use of the machinery of the banks to examine the prospect of the business or to sell off their own shares therein. They may personally borrow from the banks for supplying capital, but presumably they do so only on security that it is judged satisfactory by the

directorate as a whole. The share that banks have in their corporate capacity in industrial stock is strictly limited. It is shown separately in the accounts, and does not ordinarily exceed one-third of the owned working capital, *i.e.*, paid up capital and reserve. It thus does not come near to encroaching on the deposits of customers.*

Nevertheless by reason of the association of bank directors with industrial concerns in their inception and often for much longer periods the banks have a very considerable knowledge of and control over the industrial activities of the countries in which they operate. They lend their staff for management, afford short term accommodation and assist in raising new paid up or debenture capital. A further consequence of the connection between banking and industry is that successful industrialists are frequently to be found on the directorates of the leading banks.

If this description of the continental system is, as I believe, correct, it appears that the directorates of the banks, but not the banks themselves, play a very similar part to that which in India is played by managing agents. In so far as the leading partners of such managing agents are now often associated with the bigger banks, the parallel is still closer. But it must be remembered that employment of a fraction of a bank's original capital and of its reserve in industrial long term credit can be called banking with little more propriety than the similar investment of private capital by the *shroffs* and money-lenders.

* It is, of course, true that deposits do not form anything like as large a proportion of banking capital on the continent, as they do where British banking traditions prevail.

What then are prospects of stimulating industries by the supply of credit on this province? The major industries at present derive their credit from the general investor, who is apt to follow the fortunes of particular managing agents. I do not see any near prospect of the banks of local origin that operate in this province invading this sphere with success. It is the minor industries that depend on local resources and aptitudes that will repay more attention. But the existing capital and reserves of our own banks are scarcely sufficient for supporting any large investment in these. Hence either new capital must be sought by existing banks or a special industrial bank started. In either case it is clear that the investors must be satisfied of the good judgment and capacity of management of those, who will direct the employment of their money in industrial affairs. If these are not forthcoming the expansion of existing banks to undertake the supply of industrial credit is more than likely to endanger their position and to set back the slowly developing banking habit. The alternative of the foundation of a special industrial bank has been advocated by some of my late colleagues. I regret that we had no sufficient opportunity of discussing that proposal thoroughly. I am afraid I am still ignorant of the precise manner in which a purely industrial bank would function, even after a study of the recommendations of the other Committees. The Bombay Committee suggested that the Central Committee should formulate a scheme for starting an industrial bank in the province, and it may be hoped that the Central Committee will respond. But, as far as I can see, the success of an industrial bank depends on its power to attract long term deposits

or subscriptions to its fixed capital or debentures. With these it is expected to supply funds to enable individuals or syndicates to start industrial enterprises, and to keep itself going by charging interest on loans sufficient to pay its charges of management, interest on its own borrowings and provision for failure of some of the enterprises it finances. My fear is that if it really investigates the prospects of success its management charges will necessarily be high, and, if it does not, its provision for bad debts will have to be higher still. I do not know precisely what portion of the expenditure of the provincial Department of Industries could rightly be put down as cost of management of its banking function under the State Aid to Industries Act. But I fancy that it cannot be less than Rs. 10,000 a year, leaving aside the time gratuitously given by non-official members of the Board of Industries. At any rate the figures are available for the provision of bad debts which in seven years of working amounts to 3 lakhs against a total business done of 8 lakhs. It is not an encouraging prospect for an industrial bank in this province at any rate.

The supporters of such a scheme generally postulate substantial aid from Government funds, as the Bengal Committee says:—"Either directly or in the way of a guarantee of a minimum dividend or the interest in the debentures." I do not in the least oppose any assistance by way of expert advice, search for markets or special investigation of manufacturing problems that the State may be able, through its Industry Departments, to render to industrial development. But I am wholly unconvinced that in present circumstances it is

proper to employ the tax-payers' money to support the credit of industrial banks. Such support would either be too small to be effective, or so large as to involve a very grave risk to the financial stability of the province.

I have been speaking hitherto of the part which banks may play in providing long term finance for industries, and have expressed my personal doubts whether that part can properly be a large one. But I must not be understood to mean that banks in India or in this province cannot do sound business in providing short term credit for industry. The risk run in that business is very much less than that involved in taking up shares or debentures of industrial concerns, and it should be possible to cover it by a claim on goods in process of manufacture or stocked for sale, as well as on the more frozen assets of machinery, premises and other dead stock. We had evidence that short term loans of this kind were difficult to get from the banks operating in this province, and that the interest demanded for them was markedly high. I feel very diffident about advising bankers about their business, but the general impression that we got was that more enterprise might be shown in this respect. After all, in more fully industrialised countries the supply of credit of this kind to industries is at least comparable in magnitude to the supply of credit to commerce. I turn to the subject of thrift. Any form of banking must ultimately depend on the support of that part of the population, which has both the power and the will to save, as well as the inclination to place their savings where they can fructify for the benefit of their owners and the community at large. There is no getting away

from the fact that at present a large proportion of the population has not got the power to save substantially, if at all, living as it does too near the margin of subsistence. Of the others the rural population, that can and does save, contributes little to the resources of banking. The savings of the cultivators are invested primarily in petty money lending, next in purchase of land, followed by purchase of jewellery, trade and lastly deposit in the post office. Some still hoard but the prevalence of hoarding is probably much exaggerated. The only use of rural savings, which remotely touches banking, is deposit in the post office. But the urban population, 3 per cent. of the whole, deposits half as much again in the post offices as the rural population, and buys more than twice the value of postal cash certificates. The co-operative movement depends almost entirely on urban savings or the resources of landed proprietors, the central banks getting only 10 per cent. of their deposits from agriculturists. (In the Punjab the primary societies from the accumulated savings of the members contribute 1½ crores to the 5½ crores of total deposits of central banks, while they own another 2 crores.) The urban population at present give the only effective support to the organized institutions for investment. We estimated a total investment from the province of 15 crores, the post office taking 4½ crores, co-operative banks, insurance companies and the indigenous bankers, about 2 crores each, the Imperial Bank a little less, and the Joint Stock Banks something short of one crore. This provides an investment of about Rs. 24 per household, but undoubtedly much the greater part of organized investing is

done by the 300,000 urban households. The post office easily beats all other agencies, and in 1928-29 took in nearly half a crore of new money. Of the others few are going ahead fast, the co-operative banks only showing a net increase of deposits in 1928 of Rs. 25,000, while it is probable that deposits with indigenous banks are decreasing. On the other hand life insurance investment is going ahead, though it is still almost entirely confined to English-educated males, who live in towns. If banking is to expand in this province a great deal has to be done to stimulate both saving itself and the investment of savings, where they will be available for the organized use of credit. The stimulation of saving is not an easy matter in a population so generally poor and illiterate as that of Bihar and Orissa. Something, however, could be done by instruction in the use of money in schools and the starting therein of actual saving associations. The use of the vernacular in post office savings bank business would certainly help in rural saving. A beginning might well be made in opening post office life insurance to the general public, until such time as the ordinary life insurance companies may be ready to extend operations to the rural areas. The co-operative organization might do a great deal more than at present to stimulate saving among their solvent members especially in years of good crops and fair prices. It would greatly encourage rural saving, if better facilities for withdrawal in time of need were provided by the post office and the co-operative banks. Lastly a scheme for bringing into the sphere of organized investment a much larger proportion of that half of the population, who are traditionally thrifty in most countries of the world,

I mean the women, is urgently wanted. On such a matter I am eminently ill-qualified to advise, but I strongly commend to examination by those who are qualified the ingenious scheme which Professor Batheja put forward to be found towards the end of our Report.

The attraction of more resources to organized banking by all possible means is, I have said, essential for its expansion. But it may be asked what benefits will accrue from such an expansion. The prime object of banking is to supply legitimate credit needs and to supply them at a minimum cost. The position in this province is that the organized banks of the western type though they supply credit at a relatively moderate cost, satisfy only an insignificant portion of the total needs and are almost wholly out of touch with most of the potential customers. Of the other credit agencies by far the larger proportion supply credit only at inordinate rates, while the rest, the indigenous bankers or *shroffs* no longer command the confidence that would enable them, by attraction of deposits, to expand their business. There is at present not only a divorce between the western type of bank and the indigenous, but also between urban and rural credit agencies. To improve contact over both these gaps seems to me the principal problem of banking in this province and probably throughout India. Further with the links that commerce has established between India and the rest of the world, and those links are daily strengthening with improved communications, it is idle to ignore the fact, that banking of what for convenience sake is called the western type, is firmly established in every country that aspires to

a prominent place in civilization. This forces on one the conclusion that it is the indigenous banking system of India that must fall into line with the western. This does not mean, to me at least, that the personnel employed in it should be crushed out of existence. I believe that for a long time to come there is room for its activity, and that ultimately its merits will find a place in the special variety of the general species of western banking, which will establish itself as suitable to an Indian environment.

The first step to this end is, I think, the closer association of *shroffs* with western banks, and this means on the part of the former a lifting of the *purdah* which at present conceals their business from their associates in the world of credit. If that could be accomplished it seems certain that the experience and judgment of the *shroffs* would immensely strengthen the position of the western banks, while access to the wider money markets through those banks would greatly help the *shroffs* themselves. The *shroffs* are certainly suffering at present in the matter of attracting deposits, because no one knows how their purely banking business stands and how far the other business, on which most of them engage, is supporting or being supported by their banking assets. If as a beginning, they could be induced to place their position confidentially before a reputable western bank, and that bank showed evident signs of being satisfied, then power to attract deposits would be vastly increased. A similar breaking down of barriers between the towns and the country could, I believe, be effected if western banks either directly or through the *shroffs* could ally them-

selves with rural credit agencies of repute. Professor Batheja has pointed to the German* model, the "Kommandit" principle, "where the bank instead of opening a branch in a place becomes the financing partner of a local private banker whose advantages of unlimited liability and local knowledge are thus retained without involving the bank in the expense and heavy liabilities of a new branch."

Lastly, it must be remembered that a banking system of a western type is nowadays an essential feature in the management of the currency and credit of a country, and that by that management alone an approach to effective control of wide and disastrous fluctuation of prices can be secured. It is far beyond the scope of these lectures to attempt to explain adequately the mechanism of credit and currency control, or the limitations to its effective action, which are unfortunately patent to-day in nearly every country in the world. But it is universally accepted that control by some centralising agency is essential for preventing such violent expansion or constriction of credit as will dislocate every kind of legitimate business. Such centralising agency, whether it be the State itself or a banking authority created by the State, cannot operate effectively as long as a large proportion of the agencies for supply of credit are not only outside the widest extension of its mildest form of control, but completely beyond its ken. And

* It is interesting to note that the principle appears to have been borrowed from France where it was embodied in the Code Napoleon, though it may have developed from a mediaeval prototype common to both countries.

that is at present the position in this province, and in most of India. Whatever may be the future centralising agency in India, its considered policy must be capable of penetrating as deeply as possible through the whole economic material, so that new dangers may be met and mistakes corrected before their results become disastrous.

LECTURE VI.

Central Banks.

In the last of this series of lectures I will endeavour to give an idea of the banking organizations of some of the leading countries of the world, as an introduction to the study, which it will be necessary for thinking citizens to make before long, of the best plan to adopt for India. In doing this I have drawn largely on the last edition of Dunbar's Theory and History of Banking, which Professors Sprague and Willis have recently revised. This supplies an up-to-date survey of banking systems by economists, who have been in close touch with the revolution in central banking control, which was carried through in the United States of America in 1914 and 1915.

The ultimate aim of a centralized banking system is to maintain as far as possible a stability of price levels, since a grave departure from such stability seriously hampers all kinds of business. It is further required to maintain stability of the standard of value, the currency of the country, not only in the country itself but also in relation to those of the countries, with which there are trading relations. It has to meet occasions when for some reason or another the normal confidence, on which the smooth working of economic transactions depends, is seriously shaken. It has also to aim at checking tendencies which may result in such shaking of confidence. For all these purposes the central controlling authority must

be in a position to regulate the amount of credit available at least to some degree. The most obvious way of regulating that amount for short periods is by the expansion or contraction of actual currency. Ultimately, it may make little difference whether one has ten rupees capable of purchasing five maunds of paddy or twenty rupees capable of purchasing the same amount. But a general increase of currency or a general contraction of it will at the moment effect a very marked influence on the available amount of credit and too sudden variations will throw the whole business of the country into confusion. Hence it is recognised as essential that the supply of currency shall be centralized, and the old practice of allowing private banks to manufacture an equivalent of currency by issuing their own notes has, broadly speaking, become obsolete. The expansion of the currency is actually effected by the Central Bank buying up, with additional bank notes, bills and securities of the kind in which it is permitted to deal. Another means of regulating the available amount of credit is by securing that the ordinary lending agencies of the country keep a large proportion of their reserves with the central agency and that they shall in some degree be dependent on it for ability to draw on those reserves. But the most effective method of regulation is by means of a sliding scale of the discount, which is charged by the central agency when ordinary banks wish to realise at once on time documents, which they hold. This variation of discount rate tends to restrict or to expand the amount of extra credit that the ordinary banks can use in their business and so the amount available for their clients.

The method of creating a central agency for these purposes differs widely in different countries. I propose to examine four. In England, the Bank of England has gradually and without any concerted plan fallen into the position of a Central Bank. It is still in form a purely private bank, whose directors are elected annually by the shareholders. Curiously enough, a long established custom precludes an actual banker from sitting on the Board. But in practice the Bank has long been managed not in the interests of its shareholders, but in what the directors believe to be the interests of the public at large. Before the War it had for many years been the only authority in England that could supplement metallic currency by the issue of notes. During the War and for a period of ten years thereafter the British Government like other Governments found it necessary to expand on its own credit the currency of the country by an issue of currency notes, which reached in 1919 its maximum of £320 millions. This sum was about twice the amount of coin in circulation before 1914 and 16 times the fiduciary issue, i.e., the value of notes which the Bank of England was then authorized to issue without holding actual coin or bullion against them. But credit was in fact inflated far more, as was reflected by an increase of bank deposits from £850 millions in July 1914 to £2,100 millions in July 1919. It was not till November 1928 that Government currency notes were converted into an obligation of the Bank of England, thereby raising the "fiduciary issue" from a little under £20 millions to £260 millions. This really amounted to the Bank taking up the issue of £1 and 10 shilling notes

instead of Government, and, as these had already become established currency, the change is rather one of replacing gold in circulation than a considerable addition to the amount of currency. The only other permanent change in the matter of note issue is that the Bank can now with the consent of Government issue additional notes covered by securities for periods not exceeding two years, thus legalising for special emergencies the practice which had of necessity been followed, on four occasions between 1844 and 1914.

The Bank of England holds its commanding position not by virtue of any special enactment nor even because it is the banker of Government and carries through business arising out of the management of the public debt, nor yet mainly because it is the sole agency for issue of paper currency. Its real strength comes from the trust reposed in it by the rest of the banking agencies in Great Britain, a trust which takes the practical form of placing their balances with it, and generally of following its lead in the conduct of business. In its relations with Government on the other hand it has long been the trusted agent of the chief executive and has frequently assisted the finance of the country, when the particular aid required was against its interests as a private bank. At the same time it has preserved its independence of action.

Let us now consider how it comes about that the Bank of England can exercise control over credit, and how it actually does it. In the first place it holds the specie reserve which forms the ultimate security for credit. Prior to the War

the great part of the gold in England was in the hands of individuals as currency, and the paper currency circulation consisting of Bank of England Notes was relatively small. This is no longer the case. As has been already stated the paper currency has expanded from about £20 millions to about £420 in 1928. But the gold backing for it has remained very much in the same proportion. It was 30 per cent. in 1844, and 38 per cent. in 1928. Though there is no proportion fixed by statute, it has been one of the primary objects of the Bank to secure an adequate holding of international currency, that is gold. But it is rather with a view to meeting emergent calls on the banking system as a whole, than to provide for a sudden desire of the population of Great Britain to exchange their notes for gold, that this holding of gold is required.

The position of the Bank of England has long been peculiar in that it is the centre of a system of banks, now almost all very large institutions, who do between them a vast deal more business than the Bank itself does. Further that business is worldwide and so it comes about that the demand for credit, which the system has to satisfy, and the pressure of its liabilities on its assets are much more variable and more unpredictable than a banking system mainly confined to the business of its own country experiences. The Bank of England keeps the greater part of the fluid assets of this banking system in its charge as deposits from other banks. Something like half of its working capital is so made up. These are of course liabilities and not assets from the point of view of the Bank of England, and consequently

imposed on it is the great responsibility of conducting its business not merely so that it can meet its own liabilities, but that these resources entrusted to it are available for the support of the credit of the banks, and through the banks, of the commercial public and of England as a whole. As a consequence of its past ability to conduct its business in such a way, the outside banks are prepared to follow its lead, in controlling credit, even though there is really no immediate obligation on them to do so. The means by which this control is exercised is through varying the rate at which the Bank of England will re-discount bills, that is to say advance money on them during the remaining period before they fall due to be paid.

The Bank of France in that country has also like the Bank of England developed from a private concern into a central authority with a large degree of control over the volume of credit. It has, however, throughout its career had a somewhat closer connection with the State. Napoleon as First Consul was one of its original stockholders, and when he became Emperor he was responsible for giving it the exclusive privilege of issue of notes in Paris, and in effect throughout France. This policy was reversed during the regime of the returned Bourbons, and independent banks with the right of note issue established. But the Bank of France again became the sole bank of issue in 1848 and has continued to be so.

Unlike the Bank of England its direction is theoretically under State control, since its governor and two sub-governors are appointed and removable by the chief of the State. These are

aided by a board of 15 regents, elected by the largest shareholders, but their action is subject to a veto by the governor. In spite of this, however, the Bank has not been absorbed into the political machine, and throughout the abrupt changes of government that have occurred in France during the last 130 years, and the stress caused by the War of 1870 and the Great War it has remained in most respects independent. The governorship has not been treated as a political office and the Bank has acted as a supporter of *government* rather than of a particular administration. This result has been secured not by positive attempts to restrict the sovereignty of the State, but by judicious moderation in the exercise of that sovereignty by those through whose wills it could be exercised.

Banking in France for various reasons has followed a different course from that pursued in England. Up till the middle of the 19th century "it was conducted entirely by private banking firms working with their own capital and funds left with them more or less permanently by a limited circle of depositors." The parallel with the present business of *shroffs* is at once apparent. Since then banking companies have been established that deal in deposits and discounts, and for the last forty years these have been practically confined to four large banks, a concentration of deposit banking which was only reached in England twenty years later. The private banking firms continue, but have apparently been steadily losing ground. Recently an attempt has been made to supplement the large deposit banks, with numerous

branches worked under close centralised control, by founding small regional banks, that can take up business, depending on knowledge of character and ability, which the larger banks cannot accept. The success of this development is not yet assured.

The Bank of France does its main business by re-discounting commercial paper on which its customer banks have already advanced. But though the credit thus supplied is brought into bulk by the other banks, it is actually comprised of a large number of very small transactions. Consequently the readiness or reluctance with which the Bank of France re-discounts is generally an effective control on the expansion or restriction of credit.

Prior to the Great War the Bank of France had always aimed at maintaining as nearly as possible a stable rate of discount, and it consequently appears that its control on credit was effected rather by its power to expand or contract currency than by the power, used by the Bank of England, of increasing the price of accommodation. This difference of method reflects the much greater importance in France of the paper currency, which in England is very largely supplemented by the much more extensive use of cheques that represent private deposits in banks. But to maintain a stable rate of discount when across the Channel or the German frontier it was fluctuating, required some means of preventing an outflow of international currency, *i.e.* gold, when discount rates in London or Berlin were more favourable. This was done by the device of demanding a small premium in favour of the Bank of France for making payments in gold in place of silver, which was then legal

tender for such payments. This device is, however, no longer possible since on the revaluation of the franc in 1928, silver ceased to be legal tender in which the Bank of France could make payments. It is not yet clear what effect this change has made on the power of the Bank to control credit volume without material fluctuations in the discount rate, and its effect is at present obscured by the general confusion, which trade depression and the rapid fall in prices has brought about.

Up till 1928 a limit on the expansion of currency in France was set by a definite sum, which the total issue of notes could not exceed. In practice this sum was always raised by legislation when the limit was approached. It has now been removed and replaced by the provision of a minimum gold reserve of 35 per cent. of notes plus deposits held on demand.

The German banking system dates in its main features from the years immediately following the establishment of the Empire in 1871, though it passed through even greater difficulties than banking in England and France experienced in and after the War years. It had first to get rid of the confusion of the issues of coin and paper currency by the constituent States, and then to reorganize and restrict the issue of notes by no less than 33 different banks. The former process was rapidly effected, but the latter was only possible by degrees and there are still four banks in Germany, besides the Reichsbank, that have the right of issue. The Reichsbank itself was built up on the foundation of the Bank of Prussia, and from the very beginning was subjected to close control by the State. The Imperial Chancellor had direct power of

control and the power of appointing the board of directors, the share-holders being left merely with the power to elect a consultative committee. The new Reichsbank, which was created in 1924, after the complete collapse of the value of German currency, is likewise under strict outside control, but that control is for the present partially foreign. Its management is supervised by a General Council of seven Germans and seven foreigners. This elects the President of the Managing Board, which administers the bank, though the election requires the approval of the head of the State, the President of the German Federation. The other members of the Managing Board, who, like its President, are all Germans, have to be approved by the General Council before they can be appointed by the head of the State.

Returning to pre-War developments, it is interesting to examine how the three essential features of a central credit agency were regulated in Germany, viz., the maintenance of adequate resources of specie to meet emergent calls on the banking system as a whole, the control necessary in the public interests on the expansion of currency by the issue of notes, and the means by which the central credit agency can regulate the volume of credit.

In Germany the ordinary deposit banks did not keep large balances with the Reichsbank and consequently, if their resources for meeting an exceptional demand for specie were weakened, there was only the store of specie maintained by the Reichsbank to support general banking credit. This store, which in 1876 stood at about 500 million

marks or about 33 crores of rupees, was about three times that figure in 1913. Even so the 1913 figure of about 100 crores was actually lower than the lowest stock of specie held during the same period by the Bank of France, that held in 1880, while in 1913 the Bank of France held specie of about double the amount held by the Reichsbank.

The limitation in the public interests of the power to expand currency was secured in Germany by a special device. The Reichsbank, together with the other minor banks of issue that had survived, was empowered to issue notes against cash in hand and a specified amount beyond, which started at 385 million marks and was raised by degrees to 550 million marks with a special limit of 750 million marks for the last week of each quarter. But further these banks were authorised to exceed these limits on payment of a tax of 5 per cent. on the excess issue. The object of this provision was to allow the banks in time of commercial pressure to continue to meet the necessities of borrowers and thus to relieve the public apprehension, although practically forbidden to reap any important profit from this action. But it may be remarked that while taxed notes were issued for short periods throughout the time while this system was in force "the Reichsbank had never allowed liability to the tax to influence its policy in the determination of the rate of discount or the amount of credit to be granted."

Another provision intended to protect the public interests against inflation of currency was that the note issue should never be more than three times the store of specie. This limitation never had any

practical effect since, so far from falling as low as 33 per cent., the specie store never fell below 55 per cent.

On the creation of the new Reichsbank in 1924, the device of taxing excess note issues was abandoned. But against the whole note issue a gold or fully liquid reserve of 40 per cent. is prescribed, while against the rest of the issue certain types of bills of exchange or cheques must be held. A new feature is the provision that against deposits a reserve of 35 per cent. must be held in liquid assets, a definite recognition that, for the safety of the central banking authority, it is necessary to secure that assets are easily available, not only to meet demands for giving cash for notes, but also for repaying in cash those who have entrusted the bank with their deposits.

The Reichsbank has followed the English method of regulating the volume of credit by varying its rate of discount and not the French method of placing a premium on payment in gold. It has met with as much difficulty or even more than the Bank of England in bringing at times the rates of the outside money market into line with its own rate, but on the whole in pre-War times the system was successful in stimulating or restricting credit. In 1899 the other banks of issue were compelled by law to adopt a rate of discount in close harmony with that of the Reichsbank but this did not touch the important deposit banks, that had no right of issuing notes. In fact three of the old banks of issue preferred to surrender their rights rather than be bound to follow the Reichsbank discount rate.

The plan adopted in the United States of America for creating a central banking agency is specially interesting to us in India, since it is not only the newest experiment of its kind but is specially devised to reconcile the interests of the central government and those of the constituent States of the Union or at least of the larger regional units made up of several of those States.

The banking system of the United States started with banks incorporated under the laws of the several States, and it was not until the Civil War, 1860-64, that what are known as *national* banks, *i.e.*, banks constituted under the laws of the Federal Government, came into existence. These very numerous banks (already by 1866 there were 1634 of them) were closely regulated, as the State banks had always been. One important function of the national banks was the issue of paper currency based ultimately on the guarantee of the United States Treasury and so negotiable throughout the whole country. But in performing this function the national banks were for a long time rigidly restricted, not as in the countries we have been considering by the requirement of a definite proportion to specie held or a fixed limit above that amount, but by an obligation to take up and deposit with the Treasury, Government bonds of a value equal to or exceeding the note issue. The banks drew interest on this holding of the public debt, and made a profit of the difference between the rate on these bonds and the rate at which they could lend to the public by the issue of notes. As it turned out the steady repayment of the national debt and the rise of the national credit made the banks more and more unwilling to issue

notes against Government bonds on which they received interest, which actually went as low as 2½ per cent. Consequently the supply of bank note currency was in effect not regulated by the demand of the public for it, but by the level of the credit of the United States Government.

There was a further regulation of a different character which aimed at securing that liabilities to depositors should be met by liquid assets. The assets that could be counted fully or in part against such liabilities included not only specie and legal-tender notes of the United States, but as well sums deposited with the Clearing House Association or with certain large banks, especially those in New York. On failure to maintain the due proportion of liquid assets to deposits, a bank was prohibited from increasing its liabilities by making any fresh loans or discounts except by purchase of sight bills of exchange (i.e. it was restricted to purely remittance business), nor could it declare a dividend until the due proportion was restored. This prohibition, though no doubt logical enough as a safeguard against reckless use of deposits, in practice tends to convert a crisis into a panic. It stops the usual accommodation of the public and enforces liquidation just when it is most important to restore confidence by fairly liberal grant of loans though at high rates.

The inclusion of balances held by one bank on account of another among liquid assets supporting deposit liabilities is open to the criticism that, when the need for any large supply of liquid assets is most felt, viz., when there is general uneasiness about the solvency of banks, withdrawal of its balances by one bank from

another, which may have much larger operations, *but is not of an essentially different character,* will weaken the latter, and may lead to a widespread collapse of bank credit.

These and other defects in the United States banking system continued till 1913, when mainly as a result of the experience of the 1907 crisis, the Federal Reserve Act was passed which revolutionized the whole system. The features of the situation which that Act was designed to meet were (1) the very large number of separate national banks operating throughout the country, (2) the survival and indeed the considerable increase of State banks as well as trust companies performing banking functions, (3) the preponderance of the New York Banking Houses in the banking system, coupled with a lack of organization of these New York banks capable of securing concerted action in the general interest of the public.

The establishment of a single central bank, though strongly advocated, was discarded for a more complicated system, which takes into account the advantage of securing local management, and perhaps too of satisfying local sentiment. The country was divided up into 12 regions or districts each with a separate Federal Reserve Bank, permitted to open branches inside its own district. Each of these in purely banking matters is managed by a board mainly composed of persons selected by the existing banks, who have been admitted as member-banks. The necessary degree of supervision co-ordination and control is exercised by a Federal Reserve Board of which the members are appointed by the President of the United States.

The twelve districts naturally vary greatly in extent; roughly two-thirds of the total area, viz., the central and western States falling into only four " districts " leaving one-third for the remaining eight. One of these, the " district " of New York, only occupies about $1\frac{1}{4}$ per cent. of the whole country. Owing, however, to its great development that district actually has over 30 per cent. of the resources of the whole twelve reserve banks.

For election of the directorate of the reserve banks, member banks are grouped into three classes, large, medium and small, and each class elects one banker and one person engaged in " commerce, agriculture or some other industrial pursuit." To these six directors the Federal Reserve Board adds three government directors.

The Federal Reserve Board itself consists of eight members, including the Secretary of the Treasury and the Comptroller of the Currency ex-officio, the others requiring the consent of the Senate, *i.e.*, the Upper Chamber of the Legislature, for their appointment by the head of the State.

As we have seen in England and France the central banks have grown out of private enterprises and have accummulated their banking capital as they have progressed, while in Germany before 1871 the bank of Prussia had a large privately subscribed capital. In the United States it was necessary to provide banking capital for the inception of the Federal Reserve Banks scheme. This was secured by making all member-banks subscribe a percentage of their owned capital. But a much larger proportion of the working capital of the reserve banks is obtained from

another provision, which makes it obligatory on member-banks to keep with the reserve banks certain proportions of their demand and time deposits.

The reserve banks in the United States as elsewhere are expected to perform the function of supplying the actual paper currency that the public from time to time appears to require, as well as credit of a less general character in the shape of loans and discounts. The supply of paper currency is regulated by the requirement that against 40 per cent. of the issue of Federal Reserve notes actual gold must be held either by the Reserve Banks themselves or on their account in the Treasury. The balance requires support of collateral security in the shape of commercial paper discounted for member banks or certain classes of bills of exchange purchased by the reserve banks. There is a further provision to secure an adequate amount of specie, which is that 35 per cent. of the deposits made into the Reserve Banks must be held in gold.

Of the ways in which the Reserve Banks can influence the volume of credit the first is by the issue of notes, for which they require the definite sanction of the Federal Reserve Board though that body cannot insist on an increase of issue. The second way is by expanding or contracting credit afforded to their member banks usually in the shape of re-discounting commercial paper. They impress their control by moving the rate of re-discounting up or down. There are certain restrictions again on the class of paper which they can discount. There is, however, a third way of

influencing volume of credit, viz. by what are called "open market" operations that is to say purchase of future rights to receive money held by corporations or persons other than the member banks. These operations are, however, restricted to rights to receive from the United States Government, from the constituent States and the Municipalities, all of short term character, as well as commercial bills of exchange. By the Reserve Banks coming into the open market as buyers the supply of credit is enlarged and as the sellers to the Reserve Banks will usually re-deposit the proceeds in the member banks, these in their turn will need smaller re-discounts with the Reserve Banks. On the other hand by the Reserve Banks selling in the open market the volume of re-discounting is enlarged and rates are raised by the member banks.

In ordinary circumstances the Reserve Bank system of the United States appears to have been successful in adjusting credit supply to legitimate needs. But from all accounts it failed to operate in the face of a strong and long continued demand for credit, not really for legitimate trade and industrial purposes but for financing speculative dealings in stocks and shares.

In view of the wide differences between the different countries in the manner in which a central banking agency has been brought into being, reflecting as they do the peculiarities of political institutions as well as of economic aptitudes and requirements, it is clearly impossible to take over as a working model the banking

system of any one country and apply it to another. One is reminded of what the intelligent clerk in one of the Government of India Departments is reported to have written on a difficult file: "There are no precedents in this case; the matter must therefore be considered on its merits." It should, however, be possible to draw on the experience of all countries, when devising, as India will have to do, a system applicable to the new conditions both in the political and in the economic sphere.

In the first place it is eminently desirable that the central banking agency should have as wide an influence for credit as it is possible to secure for it. I have not yet seen any clear analysis of the causes which have contributed to the severe banking crisis in the United States that has recently occurred in spite of the creation of the Reserve Bank system designed to obviate such crises. But I suspect that one powerful cause is the impotence of the Reserve Banks to control certain types of credit, as well as the continuance of a considerable amount of banking activity which is outside the Reserve Bank system altogether.

Secondly, it is desirable that the various economic interests of the country should be constantly considered and as far as may be reconciled. We in this province may rightly urge that the interests of Calcutta and Bombay should not dominate banking policy completely. We may not be able to get a regional Reserve Bank of the United States type for our province, but it should be possible to secure by other means that, what the inhabitants of those cities, with a tinge of good humoured contempt, call mofussil interests are not overlooked.

Thirdly, it has to be decided what management of the central banking agency, which must perforce be also the currency agency, shall take the place of the despotism, benevolent or malignant, of the Government of India's Finance Department. However that management is constituted, the experience of most countries points strongly to the need for divorce or at least judicial separation between the conduct of the Central Bank and ordinary political activities. The establishment of a semi-independent management for the general banking system of a country, with a tradition of long-sighted and conservative policy, is at least as necessary in India as elsewhere in the world. It is far more important to get the best brains and character to manage the system than it is to impose elaborate checks on their scope of action, checks which experience shows are inoperative in normal times and usually inconvenient if not positively dangerous in abnormal.

Lastly, it is always important to remember that as no man can live to himself alone, so no nation can safely consider only its own immediate interests. A country's central banking system can no longer in present conditions entirely ignore worldwide interests.

What the world wants most of all nowadays is stability of price levels, and we are now experiencing the ill effects of a failure of the existing banking systems to secure that stability. It seems probable that that failure is largely due to the want of corporate action among the central banks of the leading countries. Let us hope that the new Indian Central banking system, when it emerges,

will be conspicuous for its recognition of the need for such co-operation.

I have come to the end of my attempt to fulfil the task, which the Patna University has honoured me by imposing upon me. I have only to thank the University through you for providing me with a platform from which to present my views on this difficult subject, and you, gentlemen, for giving me such a patient and attentive hearing. If what I have read here during the last week has stimulated, or may in its printed form stimulate, some of the rising generation to think more deeply on the subject of my lectures and to employ some of their leisure in testing in such ways as are open to them the validity of the views I have expressed, I shall feel very amply rewarded.

I am, personally, very well satisfied with the response accorded to me, in the matter of attendance, in view of the numerous other engagements, which I know that University students and the general public have at this time of year, and in view of the aridity with which the subject of banking is generally credited. I myself only attended two courses of professorial lectures during my University career, both on somewhat abstruse mathematical subjects, and both delivered by a man, who for his more popular lectures on astronomy could command and entrance a very large audience, the late Sir Robert Ball. For the first of these courses I shared the benches with one of the mathematical tutors of my own College and with no one else. For the second I had the privilege of forming the entire audience, except

for the sudden and surprising appearance, at one of the later lectures, of two students of the University of Los Angelos, who were engaged in sampling the most eminent lecturers of Europe. I fear that they must have found Sir Robert Ball's exposition of the way to solve the differential equations, which in those days were supposed to regulate the movements of Jupiter's satellites round the parent planet, even more lacking in spiritual uplift than my efforts to deal with credit problems.